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Supreme Court of the United States

OCTOBER TERM, 1924, No. 733.

BLAKELY D. McCAUGHN, United States Collector of Internal Revenue,

Petitioner,

versus

CHARLES H. LUDINGTON,

Respondent.

CERTIORARI TO A JUDGMENT OF THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR RESPONDENT-TAXPAYER.

WILLIAM D. GUTHRIE,
HUGH SATTERLEE,
WILLIAM R. PERKINS,
RALPH B. EVANS,
Of counsel for respondent-taxpayer.

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BRIEF ON BEHALF OF THE RESPONDENT-TAXPAYER.

The case comes before the court on certiorari to a judgment of the Circuit Court of Appeals for the Third Circuit which reversed a judgment of the District Court for the Eastern District of Pennsylvania in favor of the defendant McCaughn as Collector of Internal Revenue, filed September 26, 1923 (record, p. 7). The plaintiff in the District Court was plaintiff-in-error in the Circuit Court of Appeals, and is respondent in this court. He will be hereinafter called plaintiff.

The sole point presented for consideration and decision is the interpretation and application of sections 202 (a) and 214 (a) (5) of the Revenue Act of 1918 (approved February 24, 1919, 40 Stat. 1060-1067) in respect of what losses are deductible for income tax purposes in the case of the sale or other disposition of property acquired before March 1, 1913. These sections read as follows:

> "BASIS FOR DETERMINING GAIN OR LOSS.
>
> "Sec. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—
>
> "(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and
>
> "(2) In the case of property acquired on or after that date, the cost thereof; or the inventory value, if the inventory is made in accordance with section 203.
>
> "DEDUCTIONS ALLOWED.
>
> "Sec. 214. (a) That in computing net income there shall be allowed as deductions: . . .
>
> (5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *"

STATEMENT.

The plaintiff in the District Court sued to recover the sum of $3,094., which he had paid on November 16, 1922, under protest and duress in compliance with a demand of the defendant as Collector of Internal Revenue for an additional income tax for the year 1919 (pp. 2-4).

The demand for such additional tax arose by reason of the disallowance in part of a deduction claimed by plaintiff in his return for the year 1919 for losses sustained during the taxable year upon the sale of certain investments, namely, 490 shares of the first preferred stock of the United Gas and Electric Corporation and 60 shares of the six per cent. cumulative preferred stock of the American Cities Company (p. 3).

The 490 shares of United Gas and Electric Corporation stock were acquired by the plaintiff prior to March 1, 1913, at a cost of \$28,000; the fair market value of said shares on March 1, 1913, was \$32,445; the same were sold in 1919 for \$3,693.81, and in the return for income tax he claimed as a deductible loss the sum of \$28,751.19, which was the difference between the fair market value on March 1, 1913, and the price or amount received (p. 3).

The 60 shares of American Cities Company stock were acquired by the plaintiff prior to March 1, 1913, at a cost of \$4,500; the fair market value of said shares on March 1, 1913, was \$4,605; the same were sold in 1919 for \$173.10, and in the return for income tax he claimed as a deductible loss the sum of \$4,431.90, which was the difference between the fair market value on March 1, 1913, and the price or amount received (pp. 3-4).

The plaintiff's return for taxation for 1919 in these respects was in accordance with the official instructions to taxpayers printed on such returns, which, in turn, were in accordance with the Regulations of the Treasury Department then in force (Art. 1561, Reg. 45). Similar regulations had been in force since 1916. See appendix to this brief, pp. 6-19, 30.

The Commissioner of Internal Revenue, however, declined to recognize as the basis for ascertaining the loss sustained the fair market value as of March 1, 1913, but ruled that the basis must be the original cost, and grounded this ruling upon an amendment to Article 1561 of Regulations 45 (adopted July 28, 1921, after the decisions in the *Goodrich* and *Walsh* cases, *infra*), which amendment substituted cost for said market value and reads as follows (Appendix, pp. 41-2):

> "For the purpose of ascertaining the gain or loss from the sale or exchange of property the basis is the cost of such property, or if acquired on or after March 1, 1913, its cost or its approved inventory value. But in the case of property acquired before March 1, 1913, when its fair market value as of that date is in excess of its cost, the gain which is taxable is the excess of the amount realized therefor over such fair market value. Also in the case of property acquired before March 1, 1913, when its fair market value as of that date is lower than its cost, the deductible loss is the excess of such fair market value over the amount realized therefor. No gain or loss is recognized in the case of property sold or exchanged (*a*) at more than cost but at less than its fair market value as of March 1, 1913, or (*b*) at less than cost but more than its fair market value as of March 1, 1913." (T. D. 3206.)

The result was to substitute *cost* in place of the statutory basis of *market value as of March 1, 1913,* for ascertaining loss sustained by a taxpayer in respect of property purchased before that date whenever such cost was less than such value.

Accordingly, the Internal Revenue Commissioner reduced the deductible loss on said sales by the sum of $4,550, being the difference between the cost, viz. $32,500

and the said market value as of March 1, 1913, viz. $37,050; and this reduction increased correspondingly the taxable income of the plaintiff. The result was the additional tax of $3,094, which the plaintiff paid under duress and protest as aforesaid (pp. 2-4). A claim for refund was duly filed with the defendant Collector of Internal Revenue, but was rejected (p. 3), and the above entitled action was thereupon brought to recover the sum of $3,094 so paid as additional income tax. This action resulted in the District Court in a judgment in favor of the defendant, as aforesaid (p. 7), but the judgment was reversed on the merits by the Circuit Court of Appeals and a new trial ordered (pp. 11-16; 1 F. (2d) 689). The present certiorari brings the latter decision before this court for review.

The Circuit Court of Appeals, speaking by Circuit Judge Woolley, among other things said (pp. 14-15; 1 F. (2d), 692:

> "Reading the decisions of the Supreme Court in the Goodrich and Walsh cases as interpretations of the law only with reference to taxable gains—the subject of deductible losses was not touched—and believing that Congress is free to make its own definition of deductible losses, it follows that in construing the provision with reference to 'loss sustained' here in question, there is no constitutional limitation to be enforced and no constitutional doubt to be avoided, and hence no reason for restricted construction or for any construction which fails to give the words of the statute their plain meaning and import. United States *vs.* Standard Brewery Co., 251 U. S. 210, 217; MacKenzie *vs.* Hare, 239 U. S. 299, 308; Caminetti *vs.* United States, 242 U. S. 470, 485; Russell Motor Car Co. *vs.* United States, 261 U. S. 514, 519.

"The defendant urges upon the ground of consistency that as the Supreme Court has construed the word 'gain' to mean actual gain as distinguished from statutory gain, the word 'loss' should be construed to mean actual loss as distinguished from loss of the kind described in the words of the statute. Such identity of meaning in these provisions would, perhaps, be consistent if Congress had made it so. But Congress was free to make the provisions inconsistent if it chose. This is evidenced by the manner in which it has dealt with deductible losses in other income tax legislation. The income tax acts of the Civil War period, the revenue act of 1894 (held unconstitutional), the revenue act of 1913 allowed no deduction whatever for losses sustained from the sale of property of the kind involved in this case, although such losses might exceed the gains or profits derived from all other sources. The revenue act of 1916 allowed the deduction only of 'the losses actually sustained therein during the year to an amount not exceeding the profits arising therefrom.' The revenue act of 1918 was the first income tax law which allowed a deduction of loss however sustained, and it omitted the qualification of the word 'actually' in the phrase 'actually sustained' in the act of 1916 as well as the limitation therein 'to an amount not exceeding the profits arising therefrom.' If Congress was free to omit and to vary provisions for deductible losses in different revenue acts without relation to corresponding provisions for taxable gains, we think it had power to do the same thing in this act. Feeling that in this regard the power of Congress was not limited, we are constrained to construe the words 'loss sustained' in the section in question literally and to hold that they mean just what they say, even though, as in this instance, the loss sustained, ascertained in the manner prescribed by the statute, is greater in figures than it is in money and the effect of its

deduction from gross income is to decrease net income below its actual level. We are driven to this conclusion, startling as it may seem, because we cannot hold that Congress did not mean what it said and also because, the language of a statute being plain and its meaning clear and the statute itself being within the constitutional authority of the law-making body which passed it, our sole function is to enforce the law according to its terms. Lake Co. *vs.* Rollins, 130 U. S. 662, 670, 671; Caminetti *vs.* United States, 242 U. S. 470, 485."

It should be added that in *Flannery* v. *United States*, 4 Am. Fed. Tax Rep. 4030, decided May 19, 1924, the Court of Claims of the United States likewise upheld the contention of a taxpayer similarly situated and held that such was the plain meaning of Congress in the Act of 1918.* Answering the argument of the Government that only so-called *actual* losses were deductible, the court said:

"Congress could have required that such a loss be shown, but it did otherwise. It carefully distinguished between 'property acquired before March 1, 1913' and property acquired on or after that date. As to the former, the price or value as of March 1, 1913, governs, and as to the latter, 'the cost thereof' governs. The first of these distinctions is wiped out if the cost prior to March 1 be required, and the second clause is useless if the original cost of the property must in every case be used in ascertaining the deductible loss."

In *Vance* v. *McLaughlin, Collector,* decided April 15, 1924, by the United States District Court, California, reported in the Prentice-Hall Federal Tax Service for 1924, ¶2804 B, District Judge Bourquin said:

"The demurrer to the amended complaint is overruled.

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* The present respondent was granted leave by the Court of Claims in the Flannery case to file a brief as *Amicus Curiae* which was done by his counsel.

It is believed Congress meant what it plainly said, emphasized by the contrast between terms of pars. 1 and 2 of Sec. 202a of the Act.

And this decision is no wise inconsistent with the cases 255 U. S. They had to do with gains where there were none; this, with losses actually suffered.

For however values vary, there is no actual gain until sale and an amount realized in excess of cost. It is otherwise in the matter of losses. Any rescession in value once accrued and vested is an actual loss, and if the property is sold at recession, the loss appears and has been incurred, even though the sale be in excess of cost. That is, prior to March 1, 1913, for $10; value that date $20; sale in 1919 for $15; the owner's loss is $5, although the price received is $5 in excess of cost."

With the exception of the decision of the District Judge in the case at bar, which has been reversed by the Circuit Court of Appeals, the courts have so far uniformly sustained the contention now submitted on behalf of the plaintiff-respondent.

POINTS.

I.

THE RULINGS IN *Goodrich* v. *Edwards* and *Walsh* v. *Brewster* (255 U. S. 527 and 536) HAVE NO APPLICATION TO DEDUCTIBLE LOSSES.

In *Goodrich* v. *Edwards* and *Walsh* v. *Brewster* (255 U. S. 527 and 536), the only question before the court for adjudication was as to the meaning of the words "gain derived" in section (2) (c) of the Revenue Act of 1916, and the court was not called upon in any aspect of the controversies then before it, to consider the provisions as to "losses sustained" contained in a different section, namely, section 5 of the same Act. The pertinent portions of the Act of 1916 are printed in the appendix to this brief, page 4.

In the *Goodrich* case the taxpayer had in 1912 acquired stock in a reorganized company of the value of $291,600; the value of this stock on March 1, 1913, was $148,635.50, and it was sold in 1916 for $269,346.25. The stock had, therefore, been sold by the taxpayer at a loss of $22,253.75 as compared with original cost. Nevertheless, the Collector assessed the tax on $120,710.75, being the difference between the market value as of March 1, 1913, viz., $148,635.50, and the amount for which it was sold in 1916, viz., $269,346.25.

In the *Walsh* case two transactions were involved. In one of these transactions, the taxpayer had during

the year 1909 purchased bonds for $191,000 which he sold in 1916 for the same amount, and hence had made neither a gain nor a loss as compared with original cost. The market value of these bonds on March 1, 1913, however, was only $151,845. The tax in dispute was assessed on the difference between this amount and the amount for which they were sold in 1916, viz., $39,155. In the other transaction, the taxpayer had in 1902 and 1903 purchased bonds for $231,300, which he sold in 1916 for $276,150, or for $44,850 more than original cost; but the market value of such bonds on March 1, 1913, was $164,480. He was taxed upon the basis of the difference between such market value and the selling price, viz., $111,670, as a taxable gain although his actual gain over cost had only been $44,850.

It had then already been ruled by the Internal Revenue Bureau in this and all similar cases arising under the Revenue Act of 1916 that it was the intention of Congress to tax as "net income" of the taxpayer not simply the gain over cost, but a statutory or unrealized profit resulting from taking as a basis the market value as of March 1, 1913.

The argument on behalf of the plaintiffs-in-error in the *Goodrich* and *Walsh* cases was that the word "gain" in the Revenue Act of 1916 must necessarily be restricted to what was *"income"* within the true meaning of that term in the Sixteenth Amendment; that the authority of Congress to levy a tax under the Sixteenth Amendment was indisputably limited to "income", and that it could not fix any standard which would transmute into taxable income that which was in fact a loss and not income at

all. In other words, it was argued that as Congress could not constitutionally tax as income what was not in fact "income" and when there had in fact been no "income" because no actual gain as compared with original cost, the Act of 1916 must be construed so as to restrict the enactment within this constitutional limitation of power. Hence, it was insisted that Congress could not levy an income tax where no gain in fact existed as compared with original cost, because in final analysis such a tax would be unconstitutional in that it would be practically a burden upon and would have to be paid out of capital, and therefore, be a property tax as distinguished from an income tax, and void because not apportioned as required by the Constitution in respect of all direct taxes. *Pollock* v. *Farmers' Loan & Trust Co.*, 158 U. S. 601, 637.

The brief for the plaintiff-in-error in the *Goodrich* case contained the following statement on this point (at p. 63):

> "It is submitted that it is reasonably manifest that a construction of the Income Tax Law of 1916 which would practically result in levying a tax upon and measured by what is essentially diminished or reduced capital would be unconstitutional as being in substance and effect a direct tax payable solely in respect of capital or out of the proceeds of capital. At any rate, there are certainly 'grave doubts upon that score.' In such a case the rule in this court is to avoid a conclusion which might render a statute even of doubtful constitutionality (*United States v. Standard Brewery*, 251 U. S. 210, 220; *United States* v. *Jin Fuey Moy*, 241 U. S. 394, 401; *United States* v. *Delaware & Hudson Co.*, 213 U. S. 366), and to adopt a construction which will avoid such doubts, if reason-

> ably permissible. Moreover, equally well-settled is the rule that any doubt as to the intent of a tax law will be resolved in favor of the taxpayer. *Gould* v. *Gould,* 245 U. S. 151; *Eidman* v. *Martinez,* 184 U. S. 578, 583-590."

This argument brought about a confession of error by the learned Solicitor General. It was contained in the brief which he then filed on behalf of the Government, and this brief expressly admitted that if the construction which the Department had uniformly given to the term "gain" in the Revenue Act of 1916, and under which the taxpayer had been forced to pay the tax in question as above stated, was a correct construction, "a serious constitutional question arises", and that after a careful study of the statute the Solicitor General had been "forced to the conclusion that the Commissioner has erroneously construed the statute." The Solicitor General added that the court should construe "gain" as used in the Act of 1916 so as to restrict its application to the amount by which the selling price exceeded the cost.

Reference to the opinion of this court in the *Goodrich* case (255 U. S., at p. 535) will show that its conclusion was based upon the constitutional limitation inherent in the term "income" as used in the Sixteenth Amendment. The court in effect declared that this term had been recently defined authoritatively by it, and it quoted such definition, viz.:

> "And the definition of 'income' approved by this court is: 'The *gain* derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets.' *Eisner* v. *Macomber,* 252 U. S. 189, 207."

This limiting and controlling definition led logically to the conclusion of the court (at p. 535), namely: "It is *thus* very plain that the statute imposes the income tax on the proceeds of the sale of personal property to the extent only that *gains* are derived therefrom by the vendor; and we therefore agree with the Solocitor General that since no gain was realized on this investment by the plaintiff-in-error, no tax should have been assessed against him."

Had there been no constitutional limitation inherent in the term "income" as used in the Sixteenth Amendment and no question as to the constitutional power of Congress to tax as income what was in substance and fact not income at all, the Solicitor General would not, of course, have confessed error, and the court would not, it is submitted, have limited the language of the statute and thereby restricted the application of the standard or measure of market value on March 1, 1913, as plainly fixed by Congress.

It should, therefore, be manifest that this restrictive construction was adopted by the court in order to avoid the constitutional point and that it was in accordance with the settled rule of the court thus to construe statutes so as to avoid constitutional doubts. *United States* v. *Delaware & Hudson Co.*, 213 U. S. 366, 407-8; *Texas* v. *E. Texas R .R. Co.*, 258 U. S. 204, 217; *Arkansas Gas Co.* v. *Railroad Comm.*, 261 U. S. 379, 383.

But no constitutional question whatever arises in connection with the subject of deductible losses, or requires or permits "a more restricted construction," to quote the phrasing of Mr. Justice Van Devanter in *Texas* v.

E. Texas R. R. Co., supra (258 U. S. at p. 217). No mention of losses is made in the Sixteenth Amendment, and there is no constitutional limitation upon the power of Congress in respect of the allowance or disallowance of losses. Congress may allow or disallow them at its will or in its discretion, and upon any basis or standard it sees fit to prescribe. The Revenue Act of 1913 allowed no such deductions as are now in question, and the subsequent Act of 1916 limited such allowable deductions. Taxable gain is a constitutional concept, namely, "income" which the taxpayer has "derived" within the meaning of those words in the Sixteenth Amendment (*Eisner* v. *Macomber,* 252 U. S. 189, 207), whilst deductible loss is a wholly statutory concept and presents and involves solely a question of the intent of Congress as expressed in the language it uses. *Brushaber* case, 240 U. S. 1; *Stanton* case, 240 U. S. 103; *Labelle Iron Works* case, 256 U. S. 377, and *Mente* v. *Eisner,* 266 Fed. 161.

It must follow, therefore, that as there is no constitutional limitation to be enforced and no constitutional doubt to be avoided in the case of deductible losses, and hence no reason for a "restricted construction," the ruling in *Goodrich* v. *Edwards* and *Walsh* v. *Brewster* does not apply to deductible losses, and the language used by Congress in respect of deductible losses must be interpreted, and given effect according to its plain meaning and import. Consequently, although the term "gain derived" in section 202 (a) of the Revenue Act of 1918 must necessarily be restricted in construction so as to bring its operation within the power of Congress and the constitutional limitation to actual "income . . .

derived," under the terms of the Sixteenth Amendment, the term "loss sustained" in that section must be given effect in accordance with the ordinary and plain import and meaning of the language used by Congress to express its intent unaffected and unlimited by any constitutional limitation.

II.

Fair market price or value as of March 1, 1913, is the basis fixed by the Revenue Act of 1918, not so-called "actual loss."

It is familiar knowledge that when Congress in 1913 came to draft income tax legislation in pursuance of the authority recently conferred upon it by the Sixteenth Article of Amendment to the Constitution of the United States, it concluded that it could not constitutionally tax as income any increment or increase in value of property which had accrued prior to March 1, 1913. This conclusion was based upon the theory that all increment or increase in value accrued up to that date ought to be treated as capital value and not income because prior to that date Congress had no power to levy an unapportioned tax upon income derived from property.

Congress, therefore, provided in the Revenue Act of 1913 that, for the year 1913, "said tax shall be computed on the net income accruing from March first to December thirty-first, nineteen hundred and thirteen, both dates inclusive, after deducting five-sixths only of

the specific exemptions and deductions herein provided for;" and hence, likewise, in each of the subsequent Income Tax Laws, the practice has been uniformly and consistently followed of treating increment or increase of value which had accrued before March 1, 1913, as not subject to taxation as income under the Sixteenth Amendment. In each of such Acts, therefore, only the increment or increase of value accruing after March 1, 1913, has been taxed as income.

Thus, the Revenue Act of 1913 did not tax, and was interpreted by the Internal Revenue Bureau as not taxing, increment or increase of value that had accrued before March 1, 1913; the Revenue Act of 1916 provided (sec. 2 (c)) that in respect of property acquired before March 1, 1913, "the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived;" the Revenue Act of 1918 (sec. 202 (a)) provided that "the basis shall be—in the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date", and the Revenue Act of 1921 provided substantially the same, although adding, as shown below (p. 47), qualifying provisions so that the taxpayer should not be taxable for any more than his gain over cost in the case of property acquired prior to March 1, 1913, in order to comply with the ruling of the court in *Goodrich* v. *Edwards, supra.*

The Revenue Acts after 1913 likewise made "the fair market price or value of such property as of March first, nineteen hundred and thirteen" the basis for ascertain-

ing "losses sustained" in the case of property acquired before said date (see Act of 1916, secs. 5, 6, 10 and 12 and sec. 202, Acts of 1918 and 1921), although as shown below (p. 47) the Act of 1921 added alternative provisions not found in the prior acts. In so doing, Congress undoubtedly conceived it to be fair and just that, if increment or increase of value accruing before March 1, 1913, was to be treated by Congress as capital value and as such not constitutionally taxable as income, it should likewise be treated as capital value for the purpose of ascertaining and determining deductible loss.

To illustrate in another form of expression: each statute provided, as to property acquired before March 1, 1913, that so-called "actual gain" should not be the standard or basis; for no matter how great the ultimate "actual gain" on a sale might be over the original cost, such "actual gain" was not to be taxable as income, but only the excess, if any, of the selling price over the fair market price or value on March 1, 1913. Consequently, although the gain or increase in value between the date of purchase and March 1, 1913, might as matter of fact be many times its original cost, no income tax was levied thereon.

So, likewise, in regard to losses: no matter how great might be the decrease in value prior to March 1, 1913, no deduction whatever was allowable therefor in the Revenue Acts of 1916, 1918 and 1921, but only for decreases accruing wholly after that date.

The losses deductible under the Act of 1913 (38 Stat. 114, 167) were limited to those in trade as a result of specified casualties, and no deduction was allowed in

respect of the sale or other disposition of property except in business or trade. *Mente* v. *Eisner,* 266 Fed. 161.

"Actual gain" and "actual loss" were, therefore, not adopted in any of these statutes as the general or uniform basis or standard for ascertaining taxable gain or determining deductible loss. For example, as to deductible losses, under each statute, the cost of property acquired prior to March 1, 1913, might be $100,000; its fair market value or price on March 1, 1913, might be only $50,000, or a decrease of fifty per cent. below cost, and its selling price $50,000. Yet, although demonstrably the taxpayer had sustained an actual capital loss of $50,000 as compared with the actual cost, not one dollar of such actual loss was deductible, even under the Revenue Act of 1921.

If, therefore, "*actual* loss" was not allowable as a deduction from taxable income, there was logically no reason why *actual cost* should be a limitation on any deductible decrease in value that accrued after March 1, 1913.

The scheme of the legislation was clearly that as the basis of cost prior to March 1, 1913, was being excluded from consideration in determining taxable income when such a basis would be favorable to the taxpayer, it should likewise and reciprocally be excluded when that basis in determining deductible loss would be favorable to the Government. And the reason for these provisions clearly was that Congress intended to treat as capital the fair market value or price of property as of that date as to both gains and losses, for only on that date had the Sixteenth Amendment become effective for prac-

tical purposes. The intent and purpose of Congress in that respect accordingly should be the controlling factor in interpreting and applying the provisions of all the Revenue Acts enacted by Congress since the ratification of the Sixteenth Amendment in 1913 except only where a restricted construction is necessary to avoid conflict with some constitutional limitation.

Furthermore, it should be appreciated that gains and losses are not and never have been treated as correlative or interdependent in federal income tax legislation. The allowance or disallowance of any deduction for losses has always been regarded and treated as essentially a matter of legislative concession or discretion irrespective and independent of the actual basis of taxation on income.

The Income Tax Acts of the Civil War period, that is from 1861 to 1867 inclusive, the Revenue Act of 1894 (held unconstitutional in *Pollock* v. *Farmers Loan & Trust Co.*, 157 U. S. 429, and 158 *ib.* 601), and the Revenue Act of 1913, allowed no deduction whatever for losses sustained from the sale or other disposition of such property as is involved in the case now before this court, that is to say, "transactions entered into for profit but not connected with" the taxpayer's business or trade, although such losses might equal or exceed the gains or profits derived from all other sources. The Revenue Act of 1916, section 5, subdivision "Fifth", allowed the deduction only of "the losses *actually* sustained therein during the year to an amount not exceeding the profits arising therefrom." In fact, the Revenue Act of 1918 was the first income tax law which

ever allowed a deduction of loss however sustained, and it significantly omitted the limitation and qualification of the word "*actually*" in the phrase "actually sustained" in the Act of 1916 as well as the limitation therein "to an amount not exceeding the profits arising therefrom."

The above reasoning should be additionally conclusive if we bear in mind the fact that when the Revenue Act of 1918 was enacted decisions on this general subject had been rendered by the lower federal courts (*Mitchell Bros. Co.* v. *Doyle,* 225 Fed. 437, 439, 440, affirmed 235 Fed. 686, 691, and *Lynch* v. *Turrish,* 236 Fed. 653, 660, and affirmed by this court; see also *Doyle* v. *Mitchell Bros. Co.,* 247 U. S. 179, and *Lynch* v. *Turrish,* 247 U. S. 221), with the result that in the *Doyle* case the controlling principle was declared by this court to be "in order to determine whether there has been gain or loss, and the amount of the gain, if any, *we must withdraw from the gross proceeds an amount sufficient to restore the capital value that existed at the commencement of the period under consideration*" (247 U. S. at p. 185).

In T. D. 2740, promulgated by the Treasury Department, June 24, 1918, the foregoing decisions, among others, were listed, and therefrom were drawn certain conclusions, among them that of the controlling principle above expressed.

And in T. B. M. 73 (1 C. B. 35) the Tax Board explained this T. D. and these decisions to mean—

> "The principle underlying the Treasury Decision above referred to and the cases upon which it is based is that the gain or loss resulting from a sale of corporate stock is the difference between

> its value on March 1, 1913 (or, more accurately, Feb. 28, 1913), and the proceeds of the sale, . . ."

It is submitted, therefore, that the Government is in error in assuming that Congress intended that only "*actual losses*" should be deducted. Had Congress so intended, it would readily have found appropriate language, as it did in the revision embodied in the Revenue Act of 1921. The uniform general basis adopted by Congress plainly operated in most cases in favor of the Government by excluding as a deductible loss any decrease in value that had occurred prior to March 1, 1913, and in favor of the taxpayer only in those cases where values rose between purchase and March 1, 1913, and then fell again before the property was sold.

III.

The Revenue Act of 1918 expressly states that the basis of deductible loss shall be the fair market price or value as of March 1, 1913, and the plain meaning of this statutory language is controlling.

There can be no reasonable doubt that the language of section 202 (a) of the Revenue Act of 1918 above quoted (p. 2) and now before the court for interpretation and enforcement is perfectly plain and unambiguous, and that its ordinary import and meaning are obvious. It is general in application and permits of no such exception as is now sought to be incorporated. There is no

constitutional reason for a restricted construction, or for enforcing or implying any limitation upon the power of Congress. In the simplest and plainest form of expression that could possibly have been adopted it is provided "that in computing net income" certain losses "shall be allowed as deductions" (sec. 214 (a) (5)), and "that for the purpose of ascertaining the . . . loss sustained from the sale of . . . property *the basis shall be,* in the case of property acquired before March 1, 1913, *the fair market price or value of such property as of that date;* and, in the case of property acquired on or after that date, the *cost* thereof" (sec. 202 (a)). It would, indeed, be impossible to employ language more explicitly and unmistakably evidencing the discriminating intention of Congress to provide only for these two bases or standards with no exceptions, that is to say, on the one hand, the basis for *fair market price or value as of March 1, 1913,* as to property acquired before that date, and on the other hand, *cost* as to property acquired after that date.

Thus, the basis of market price or value on March 1, 1913, was to apply in the case of property acquired before that date, and the basis of cost in the case of property acquired after that date. There is nothing in the statute to warrant the slightest doubt as to the intention of Congress, in respect of deductible losses, or tending to create any ambiguity, or to suggest in the remotest degree that Congress did not mean exactly what it said, namely, *market value as of March 1, 1913,* in the one case, and *cost* in the other, and did not intend that this very plain and simple provision fixing the basis for ascertain-

ing all deductible losses should be enforced according to its letter. Since increases in value accrued prior to March 1, 1913, were treated, as they have been in all the Revenue Acts under the Sixteenth Amendment, as non-taxable because in substance and effect "capital value" (the term used by this court in the *Doyle* case, 247 U. S. at p. 185) existing as of that date, it was quite reasonable, consistent and logical to treat such accrued increase in value likewise as "capital value" for the purpose of computing deductible losses occurring or arising after that date.

It must be borne in mind—and this is repeated because it tends to clarify the discussion and avoid confusion of thought—that *taxable gain* and *deductible loss* in federal income tax legislation are not at all correlative subjects or in any sense interdependent, and that they have never been so regarded or treated by Congress. It has always allowed or disallowed deductions as it saw fit. As to taxable gains accruing after March 1, 1913, Congress was acting under the constitutional limitation on its power and discretion that only actual income could be taxed, and not theoretical gain, even though based upon the assumption that accrued increase or increment in value as of that date had become in practical effect part of the capital of the taxpayer; but, as we have seen, no such constitutional limitation exists or applies to the allowance or disallowance of deductible losses.

If the Revenue Act of 1918 had intended that "cost" should be the controlling factor in ascertaining loss in the case of property acquired before March 1, 1913, as the Government now contends, this section clearly would not

have declared the basis for ascertaining such loss to be the market price or value on March 1, 1913, and omit all reference to "cost" as a factor, when this very section explicitly makes "cost" the basis for such purpose with respect to property acquired on or after March 1, 1913. It will not do to say that Congress overlooked such an important aspect as cost prior to March 1, 1913; for it certainly had "cost" in mind as a basis in drafting this section, and must have realized the difference between the uniform basis of market value on March 1, 1913, as to both gains and losses, and an alternative basis of market value or cost whichever was respectively higher or lower. We are, therefore, led to the conclusion that the Revenue Act of 1918 in section 202 stated "the basis shall be" cost in the one case and market value in the other, because Congress meant that very thing and nothing else.

It must be equally manifest that section 202 was intended to be a complete and definitive formula. It is complete as to kind of property, applying whether the property be "real, personal or mixed." It is complete as to form of the transaction, applying whether the form be a "sale or other disposition". It is complete as to time of the transaction, applying whether the acquisition occurred before or after March 1, 1913. And it is complete as to establishment of a formula, dividing all such transactions into two groups at the point of time of March 1, 1913, and declaring that "the basis shall be" "the fair market price or value" *as of that date* as to one group, and as to the other group "cost".

Two other provisions of the Act of 1918 also persuasively show the intent of Congress as to the basis of March 1, 1913, and its ability to discriminate when it so intended.

Thus, (1) section 202 (b) provides as to the excess par or face value of new stock received on a reorganization as follows:

> "The amount of the excess in par or face value shall be treated as a gain to the extent that the fair market value of the new stock or securities is greater than the cost (or if acquired prior to March 1, 1913, the fair market value as of that date) of the stock or securities exchanged."

And (2) depletion and depreciation of improvements in the case of mines, wells, timber, etc., are required to be—

> "based upon cost including cost of developments not otherwise deducted: *provided,* That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken *in lieu of cost* up to that date:" (Secs. 214 (a) (10) and 234 (a) (9)).

Unquestionably, Congress manifested in each of these two provisions its intent to substitute market value in lieu of cost in respect of property acquired before March 1, 1913. As kindred provisions, they show that Congress intended the same thing in the earlier part of section 202 when it said "the basis shall be" market value as of that date. All these provisions, though varying slightly in words or arrangement, not only clearly evidence but express and carry out the same idea of taking value as of March 1, 1913, and making it "capital value" and as such the basis for determining taxable gain or deductible loss.

Yet, if the new departmental construction should now prevail, market value will not only *not* be "*the* basis" for determining deductible loss, but there will be many cases in which it will not be the basis or factor at all.

This court will not fail to note that the learned District Court found it necessary to interpolate the word "actual" in stating the intent of Congress to be that "only *actual* losses" should be deductible (p. 6). But the statute does not say so, and when Congress came later to express the very idea that the District Court thus implied as its prior intention, it deemed it necessary to use the elaborate phraseology of the Act of 1921 discussed at pp. 47-53, *infra*.

The learned District Court, it is submitted, made an inapposite choice of words in referring to "actual" gains and losses, and "fictitious or paper" profits and losses. The qualifying adjectives used by the District Court are not found in the Constitution or statutes, nor in either of the opinions of this court relied upon. It seems to have assumed that "actual" loss upon the sale of property could only be determined by a comparison of original or actual cost with sale price, and the opinion concludes with the declaration, quite *non sequitur,* that "the plaintiff therefore was not entitled to a deduction in excess of his actual loss . . ."

It is true that the loss of the taxpayer, determined in accordance with the provisions of the statute by comparing the value of the property as of March 1, 1913, with the sale price exceeded the difference between original cost and sale price. But it by no means follows that any part of this loss was not real or actual, or that any

part of it was "fictitious or paper"; just as it does not follow that market value as of March 1, 1913, was not in real substance and effect "capital value" as distinctly recognized by this court in the *Doyle* case, *supra*.

If a landowner constructed a building in 1905 at a cost of $50,000, and in 1913, owing to rising costs of material and labor, the building had a realizable market value of $100,000, and if this building were destroyed by fire arising through the negligence of a railroad company, who is there who would argue that the owner did not suffer a real and actual loss of $100,000 and was not entitled justly to recover on that basis? Who could reasonably assert that $50,000 of the loss was "fictitious or paper"? Surely, the courts would not hesitate to give judgment for $100,000 against the railroad company on the ground that that amount was the actual loss sustained. Nor would they hesitate to make an insurance company pay $100,000 if the building had been insured for that amount; nor would they consider under such circumstances as at all material that they were giving judgment in excess of the owner's *actual* loss.

Suppose, again, a farm had been purchased twenty or thirty or forty years before 1913 and had increased many times in value—of which innumerable instances in all States could readily be found and cited—would it be fair in determining loss in case of a sale below the value in 1913 to say that such value was "fictitious or paper" and that recourse must be had to original cost twenty, thirty, or forty years before?

A man who owned a building or securities worth $100,000 at their market value on March 1, 1913, would

clearly be in a position to sustain a loss of that amount—real and actual loss—regardless of what the property originally cost him, or whether he had acquired it by purchase or by gift.

Again: suppose a man bought 1,000 shares of stock in a company twenty years before March, 1913, for $10 a share and the company had so prospered that the stock in 1913 was quoted and readily salable on the market at $100 per share, and suppose thereafter, the earnings of the corporation fell off, cutting the dividends and the market value of the stock, say, in half, and he thereupon sold at $50 per share, would he not suffer an actual loss of $50 per share just as real and just as far from being "fictitious or paper" as if he had bought the stock in 1913 at $100 per share? Would he not realize only one-half of what he was actually worth or of his actual "capital value" in 1913?

A gain or loss, therefore, may be just as real when computed with reference to fair market price or value at a given date as when computed with reference to antecedent cost or value at another date.

One acquiring property by gift was regarded under the Revenue Acts of 1913, 1916 and 1918 as taking the property for the purpose of a subsequent computation of gain or loss at its *value* at the date of acquisition and not at its cost to the donor, or to the donee, which latter was nothing. The only reason for taking cost in those computations under the tax laws in which cost was made the basis, was that cost is generally the best evidence of value at the time of acquisition. The difference between value at the time of acquisition (evi-

denced by cost) and sale price may be gain or loss in some circumstances. The difference between value at some other date and sale price may be gain or loss under other circumstances. In either case it is the difference between *value* and sale price. Whether the *value* be taken at one time or at another does not make the gain or loss any more real or actual or any more "fictitious or paper."

Suppose a man carrying on business finds that the market value of his stock in trade drops 50 per cent during the year, so that the same goods represent only half as much on his closing inventory as they did on his opening inventory. Although he has not actually sold the goods, the Treasury Department permits him to deduct this difference between his opening and his closing inventory on the sound theory that he has realized a "capital value" loss to that extent. And this loss is real. If it were "fictitious or paper", would the Government, arguing as it does in the case at bar, permit its deduction? And if a loss representing the difference between opening and closing inventories be, for practical business and administrative purposes, sufficiently real to be deductible, why may not a loss representing the difference between March 1, 1913, market value and sale price? One is no more actual than the other.

The scheme of the income tax laws prior to that of 1921 was to take the value as at March 1, 1913, of property acquired before that date, rather than the value at acquisition or at any other date, for the basis in computing both gains and losses as being in accord with the best and latest adjudications.

Thus, this court said in *Doyle* v. *Mitchell Brothers Co.*, 247 U. S. 179, 185:

> "In order to determine *whether there has been gain or loss,* and the amount of the gain, if any, we must withdraw from the gross proceeds an amount sufficient to restore the *capital value* that existed at the *commencement of the period* under consideration.
>
> "This has been recognized from the beginning by the administrative officers of the Government." (Italics ours.)

The period under consideration referred to was not, therefore, the period of acquisition or ownership by the taxpayer but the period of the existence of the law under construction.

As pointed out above, there is no constitution limitation to be enforced and no restrictive construction required in the case of such deductions as Congress may or may not see fit to allow, and it follows that "it is not within the judicial province to give to the words used by Congress a narrower meaning than they are manifestly intended to bear" (*Trade Mark Cases,* 100 U. S. 82, 98, quoted with approval in *Butts* v. *Merchants Transportation Co.,* 230 U. S. 126, 136; see also *Hill* v. *Wallace,* 259 U. S. 44, 70). It is, of course, unnecessary to argue that questions of expediency or economic equivalency or other similar policies "are beyond judicial cognizance" (*Brushaber* v. *Union Pacific R. R. Co.,* 240 U. S. 1, 25). The will of Congress as evidenced by its plain and unambiguous language must be given effect, for it alone can determine what deductions are to be allowed. The courts cannot revise a taxing statute to adjust its impositions and allowances or to accord with some idea of economic

desirability or expediency or equivalency. And if there be any doubts, they must be resolved in favor of the taxpayer (*Gould* v. *Gould,* 245 U. S. 151).

Thus, Mr. Justice Sutherland, in delivering the opinion of the court in the recent case of *U. S.* v. *Merriam,* 263 U. S. 179, 187, stated and applied this principle as follows:

> "On behalf of the government it is urged that taxation is a practical matter and concerns itself with the substance of the thing upon which the tax is imposed rather than with legal forms or expressions. But in statutes levying taxes the literal meaning of the words employed is most important for such statutes are not to be extended by implication beyond the clear import of the language used. If the words are doubtful, the doubt must be resolved against the government and in favor of the taxpayer. Gould *v.* Gould, 245 U. S. 151, 153, 38 Sup. Ct. 53, 62 L. Ed. 211. The rule is stated by Lord Cairns in Partington *v.* Attorney General, L. R. 4 H. L. 100, 122:
>
> 'I am not at all sure that in a case of this kind—a fiscal case—form is not amply sufficient; because, as I understand the principle of all fiscal legislation, it is this: If the person sought to be taxed comes within the letter of the law, he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be. In other words, if there be admissible in any statute what is called an equitable construction, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute.'
>
> "And see Eidman *v.* Martinez, 184 U. S. 578, 583, 22 Sup. Ct. 515, 46 L. Ed. 697."

Moreover, courts cannot recoup the Government for what it may lose under the doctrine of the *Goodrich* case and its enforcement of a constitutional limitation. They cannot assume that Congress would have disallowed deductions on the basis of the market value as of March 1, 1913, if it had appreciated that it could not tax as income what was not in fact income. No court can say that Congress in grounding its whole scheme of income taxation upon the basis of market value on March 1, 1913, and treating *value* as of that date as "capital value", would not have allowed as deductible losses any decrease in such capital value after that date. If Congress recognized, as it did, the fairness and reasonableness or the constitutional necessity of treating market value as of March 1, 1913, as practically the capital value of property then owned by the taxpayer and increases in value then accrued as not taxable income, it was equally fair and reasonable to fix the same basis for the ascertainment and determination of deductible losses.

In a word, it is not within the legitimate power of the judiciary or its function or province to limit the plain meaning and import of the language used by Congress. As no constitutional limitation and no constitutional question are involved in the case of deductible losses, no limitation of or implication contrary to the plain letter of the statute is permissible or can be indulged or grafted or interpolated by the courts. *Commissioner of Immigration* v. *Gottlieb*, 265 U. S. 310, 313; *United States* v. *Standard Brewery*, 251 U. S. 210, 217; *Caminetti* v. *United States*, 242 U. S. 470, 485; *Mackenzie* v. *Hare*, 239

U. S. 299, 308; *United States* v. *Goldenberg,* 168 U. S. 95, 102-3; *Maxwell* v. *Moore,* 22 How. 185, 191.

Referring to this well-settled rule, the court at this term declared in the case of *Michaelson* v. *United States, etc., and Sandefur* v. *Canoe Creek Coal Co.,* 45 Sup. Ct. 18, 69 L. ed.—, Adv. Ops. 14, as follows:

> "If Congress had intended such an exception, it is fair to suppose that it would have said so affirmatively. The words of the act are plain and in terms inclusive of all classes of employment; and we find nothing in them which requires a resort to judicial construction. The reasoning of the court below really does not present a question of statutory construction, but rather an argument justifying the supposititious exception on the ground of necessity or of policy—a matter addressed to the legislative and not the judicial authority."

If it be argued on behalf of the Government that as the word "loss" is found in the Revenue Act of 1918 (although not in the Act of 1916) in immediate connection with and juxtaposition to the word "gain", and as "gain" has been construed so as to be restricted to "actual gain", the word "loss" should similarly be limited and restricted by reason of the doctrine of *noscitur a sociis,* the refutation of such an argument will, it is submitted, be sufficiently found in the recent case of *Russell Motor Car Co.* v. *United States,* 261 U. S. 514, 519, where Mr. Justice Sutherland, speaking for the court, used the following language:

> "Then it is said that inasmuch as the application of the word 'requisition' must be confined to private contracts, the other words associated with it must be likewise restricted by virtue of

the maxim *Noscitur a sociis.* That a word may be known by the company it keeps is, however, not an invariable rule, for the word may have a character of its own not to be submerged by its association. Rules of statutory construction are to be invoked as aids to the ascertainment of the meaning or application of words otherwise obsecure or doubtful. They have no place, as this Court has many times held, except in the domain of ambiguity. *Hamilton* v. *Rathbone,* 175 U. S. 414, 421; *United States* v. *Barnes,* 222 U. S. 513, 518-519. They may not be used to create but only to remove doubt. *Id.* Moreover, in cases of ambiguity the rule here relied upon is not exclusive. The problem may be submitted to all appropriate and reasonable tests, of which *Noscitur a sociis* is one. Here we have one word which it may be conceded applies only to private contracts, but the other three words standing alone, it likewise must be conceded, naturally apply to governmental contracts as well * * *.

"* * * *Noscitur a sociis* is a well established and useful rule of construction where words are of obscure or doubtful meaning; and then, but only then, its aid may be sought to remove the obscurity or doubt by reference to the associated words. *Virginia* v. *Tennessee,* 148 U. S. 503, 519; *Benson* v. *Chicago, etc. Ry. Co.,* 75 Minn. 163. But here the meaning of the words considered severally is not in doubt, and the rule is invoked not to remove an obscurity but to import one. There is nothing in the rule or in the statute which requires us to assimilate the words 'modify' and 'cancel' to the scope of the word 'requisition', simply because the latter has a necessarily narrower application. The meaning of the several words, standing apart, being perfectly plain, what should be done is to apply them distributively, *diverso intuitu,* giving to each its natural value and appropriate scope when read in connection with the object (any contract) which they are severally meant to control. Thus, the predicate 'requisi-

> tion' will be limited to private contracts, while the other words may be appropriately extended to include governmental contracts as well. An illustration is afforded by the Commerce Clause of the Constitution. The power to regulate interstate and foreign commerce is found in the same clause and conferred by the same words, but the scope of the power when applied to the former may be narrower than when applied to the latter. *Groves* v. *Slaughter,* 15 Pet. 449, 505."

As indicated above, and repetition is, perhaps, permissible for the sake of emphasis, it would be entirely erroneous to contend that taxable gain and deductible loss are corresponding and correlative concepts which have gone hand in hand through the Revenue Acts. The contrary is clearly true. All the Revenue Acts levying income taxes from that of 1913 to date have taxed as income any gain, whether or not the gain arose from a trade or business or any transaction entered into for profit. Thus, for example, a gain derived from the sale by a manufacturer of shares of stock, or a merchant of his residence, or a lawyer of his pleasure automobile, has always been taxed as income irrespective of his business losses. An entirely different rule has, however, always prevailed as to deductible loss. Under the Revenue Act of 1913, the loss had to be "incurred in trade", and, therefore, a loss sustained by the manufacturer on a sale of shares of stock was not deductible under that Act (*Mente* v. *Eisner,* 266 Fed. 161). Under the Acts of 1916 and 1917 losses incurred in a transaction if *entered into for profit* but not connected with the trade or business of the taxpayer could be deducted only to an amount not exceeding the profits arising from such transactions. Gains

in illegal transactions have always been held by the Treasury Department to be taxable, whilst the Department has never permitted the deduction of losses in similar transactions. And under none of the Revenue Acts has a taxpayer been allowed to deduct a loss sustained through the sale of a residence or a pleasure automobile (Art. 141, Reg. 45; O-780, 1 C. B., p. 117). In a word, while every gain has been uniformly taxed, not every loss, even though indisputably "actual", has been allowed or deducted.

IV.

THE LANGUAGE OF THE REVENUE ACT OF 1918 IS MORE DEFINITE AND CERTAIN THAN THE LANGUAGE OF THE REVENUE ACT OF 1916 AND MORE FAVORABLE TO THE TAXPAYER.

The pertinent provisions of the Revenue Acts of 1916 and 1918 are respectively as follows:

REVENUE ACT OF 1916	REVENUE ACT OF 1918
"For the purpose of ascertaining the gain derived from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the	"That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be— (1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

amount of such gain derived." (Sec. 2 (c).)

"That in computing net income in the case of a citizen or resident of the United States—

(a) For the purpose of the tax there shall be allowed as deductions—

Fourth. Losses actually sustained during the year, incurred in his business or trade, or arising from fires, storms, shipwreck, or other casualty, and from theft, when such losses are not compensated for by insurance or otherwise: *Provided,* That for the purpose of ascertaining the loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such loss sustained;" (Sec. 5 (a)).

"For the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition by a corporation, joint-stock company or association, or insurance

(2) In the case of property acquired on or after that date, the cost thereof; or the inventory value, if the inventory is made in accordance with section 203." (Sec. 202 (a).)

"That in computing net income there shall be allowed as deductions:—

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;

(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; but in the case of a nonresident alien individual only as to such transactions within the United States;

(6) Losses sustained during the taxable year of property not connected with the trade or business (but in the case of a nonresident alien individual only property within the United States) if arising from fires, storms, shipwreck, or other casualty, or from theft, and if not compensated for by insur-

company, of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived or loss sustained." (Sec. 10.)

ance or otherwise;" (Sec. 214 (a)).

"That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:—

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise;" (Sec. 234 (a)).

From the start the construction placed upon the language of the Revenue Act of 1916 by the Treasury Department was that the basis of value as of March 1, 1913, applied exclusively in the case of property acquired before March 1, 1913, and that cost applied exclusively in the case of property acquired on or after that date (see appendix, pp. 24-34). The Revenue Act of 1918 in unmistakable language adopted and embodied this practical, administrative construction.

The 1918 Act was more liberal to the taxpayer in the matter of deductions for losses than the Act of 1916, as it allowed without limit losses in transactions entered into for profit, though not connected with the trade or business and though not arising through fire, storm, shipwreck, etc.

It has, however, been rather subtly argued that the sections providing for ascertaining gain or loss apply only to ascertaining the *amount*, after the *fact* of gain or loss is otherwise once determined. In the 1916 Act the provisions begin "for the purpose of ascertaining the $\left\{\begin{matrix}\text{gain derived}\\ \text{loss sustained}\end{matrix}\right\}$," and end with the direction that "the

fair market price or value of such property shall be the basis for determining the *amount of* $\left\{\begin{matrix}\text{such gain derived}\\ \text{such loss sustained}\end{matrix}\right\}$".
Even if this reference to *amount* might possibly and subtly be construed as a limitation upon what was to be ascertained in this manner, nevertheless in the 1918 Act the term *amount* disappeared, and the language employed was "that for the purpose of ascertaining the gain derived or loss sustained . . . the basis shall be . . . the fair market price or value of such property," etc.

Moreover, the Revenue Act of 1916 only permitted the deduction of losses "*actually* sustained", while the Revenue Act of 1918 now before this court for construction and application allows the deduction of "losses sustained", the word "actually" having been eliminated.

V.

Effect of uniform departmental construction and of substantial re-enactment in the Revenue Act of 1918 of the provision as to deductible losses contained in the Act of 1916.

The Treasury Department from 1916 to 1921 uniformly and consistently interpreted the Revenue Acts of 1916 and 1918 in every case as prescribing and fixing the basis of market value as of March 1, 1913, and not cost for ascertaining the amount of deductible loss. Pertinent regulations and decisions of the Department are printed in the appendix filed with the present brief.

This long practical interpretation by the experts of the Treasury Department was clearly in accord with the plain import and meaning of the language employed by Congress. Indeed, it seems never to have occurred to these experts that any doubt was possible until the *Goodrich* case showed that Congress could not tax as income what was in fact and truth not income at all within the true meaning of the term as used in the Sixteenth Amendment, and that, therefore, a restricted construction was necessary as to taxable gain.

The practical interpretation thus applied by the Treasury Department was uniformly enforced for six years, and taxpayers were instructed to make out their returns from 1916 to 1921 inclusive upon that basis. Innumerable have been the instances of reliance upon such practical departmental or administrative interpretation and consequent adjustment of taxpayers' affairs. When the plaintiff in the case at bar filled out his return for the year 1919 he relied, and surely was entitled to rely, not only upon the language of the statute, but upon the rulings of the Department and the official forms it furnished. It was not in fact until long after the filing of this return that there came about the complete change of mind by the Department and the setting aside of its long enforced regulations; and it was only pursuant to such change that the levy of the additional tax on plaintiff was made in November, 1922.

Furthermore, in Article 141 of Regulations 45 as originally promulgated under the Revenue Act of 1918, it was provided that, when loss through casualty was

claimed, the amount deductible in the case of property acquired before March 1, 1913, should be the difference between its fair market value as of that date and the salvage value thereof, taking into account the amount set aside for depreciation, as well as insurance received on account of the loss.

In T. D. 3206, promulgated July 28, 1921, consequent upon the decisions in *Goodrich* v. *Edwards* and *Walsh* v. *Brewster,* this portion of Article 141 was changed so as to provide that when the fair market value as of March 1, 1913, was higher than cost, the deductible loss should be the difference between cost and the salvage value, and that no loss should be recognized where the salvage value was less than the cost but more than the depreciated value of the property as of March 1, 1913.

By the Revenue Act of 1921, however, this latter standard was repudiated by Congress, and it was specifically provided as to losses by casualty as follows:

> "In case of losses arising from destruction of or damage to property, where the property so destroyed or damaged was acquired before March 1, 1913, the deduction shall be computed upon the basis of its fair market price or value as of March 1, 1913;" (Secs. 214 (a) (6) and 234 (a) (4)).

The court will note that the language thus used is exactly the same as that contained in section 202 (a) of the Act of 1918 under review in this case, and as to which we have the two above conflicting constructions by the Department, first by Article 141 of Regulations 45, and secondly by T. D. 3206; and it was adopted according to the Conference report "to remove all doubt" as to what Congress intended (*post,* p. 51).

This court has again and again declared that such a departmental construction is entitled to great respect and ought not to be disregarded without cogent and persuasive reasons, such as the constitutional limitations which operated in *Goodrich* v. *Edwards* and *Walsh* v. *Brewster*. See *Logan* v. *Davis,* 233 U. S. 613, 627; *Kern River Co.* v. *United States,* 257 U. S. 147, 154; *LaRoque* v. *United States,* 239 U. S. 62, 64. This rule is so familiar that it is unnecessary to quote from the opinions.

Moreover, it is a real hardship upon taxpayers to be compelled years after paying income taxes in conformity with the rules prescribed by the Department to be mulcted in additional taxes because of a subsequent departmental change in the interpretation of the applicable statute. In *Rock Spring Co.* v. *W. A. Gaines & Co.,* 246 U. S., at p. 320, this court quoted with approval the following statement by Circuit Judge Sanborn in *Layton Pure Food Co.* v. *Church & D. Co.,* 182 Fed. 35, 39:

> "Uniformity and certainty in rules of property are often more important and desirable than technical correctness."

But equally important, if not controlling, is the reenactment in the Revenue Act of 1918 of the provisions of the Act of 1916 substantially to the same effect in regard to the allowance of deductible losses.

In an opinion of the Attorney General under date of August 23, 1922 (T. D. 3393, 33 Op. Atty. Gen. 291), printed in full in the appendix to this brief (at p. 59), it was said:

> "No substantial changes having been made in the corresponding sections of the two Acts [1916

> and 1918], it is assumed that both Acts were intended by Congress to have the same construction, and the same basis should be employed in arriving at taxable gains and deductible losses upon the sale or other disposition of property."

This re-enactment in the Revenue Act of 1918 of the provision now in question in substantially the same terms as it appeared in the Revenue Act of 1916, particularly in view of this opinion of the Attorney General, was, it is submitted, an adoption by Congress of the practical construction of the prior Revenue Act by the executive officers of the Government.

United States v. *Falk,* 204 U. S. 143, 152; *Copper Queen Consolidated Mining Co.* v. *Arizona Board,* 206 U. S. 474, 479; *United States* v. *Cerecedo Hermanos y Compania,* 209 U. S. 337, 339; *Latimer* v. *United States,* 223 U. S. 501, 504; *National Lead Co.* v. *United States,* 252 U. S. 140, 146-7; *Heald* v. *District of Columbia,* 254 U. S. 20, 23.

Moreover, the construction put by the Government upon the Revenue Act of 1918 is based upon no authority other than the Treasury Department's regulation and the opinion of the Attorney General mentioned above. In that opinion the Attorney General among other things says (appendix, p. 63):

> "Taxable gain having been thus construed by the Supreme Court, it follows that 'deductible loss' should have the same construction, the provisions relating to losses being practically identical with those relating to gain. In making the concession as to taxable gains, the Solicitor General, in his brief in the Goodrich cases, cited above, made the further concession that a loss on the complete transaction must have been sustained

in order to make it a deductible loss, and that only the loss occurring subsequent to March 1, 1913, should be allowed as a deduction. . . ."

"Replying specifically to the inquiry, I am of the opinion that where property acquired prior to March 1, 1913, is sold or disposed of thereafter—

"(a) Taxable gain resulted if the selling price was higher than the value on March 1, 1913, and if that value was higher than the cost thereof, to the extent that the selling price exceeded the value on March 1, 1913;

(b) Taxable gain resulted if the selling price was greater than the cost and if the cost was greater than the value on March 1, 1913, to the extent that the selling price exceeded the cost of the property sold or disposed of;

(c) No taxable gain or allowable loss resulted if the selling price was greater than the value of the property on March 1, 1913, but less than the cost thereof;

(d) An allowable loss resulted if the selling price was less than the value on March 1, 1913, and if that value was less than the cost to the extent of the difference between the value on March 1, 1913, and the selling price;

(e) No taxable gain or deductible loss resulted if the selling price was less than the value thereof on March 1, 1913, but greater than the cost; or

(f) An allowable loss resulted if the selling price was less than the cost and if the cost was less than the value on March 1, 1913, to the extent that the cost of the property disposed of exceeded the selling price thereof."

The Attorney General thus declares that "deductible loss" should have the *same* construction, but he then proceeds to give it a diametrically opposite construction. If we are to interpolate the words "or cost, whichever is higher" with respect to the basis for determining gains,

we should interpolate the *same* words "whichever is higher" with respect to the basis for determining losses —not the exactly opposite words "whichever is lower" which the construction of the learned Attorney General in effect requires.

In the Revenue Act of 1924 the Congress clearly recognized the incongruity we have mentioned of ascertaining "gains" on the basis of whichever is higher, and "losses" on the basis of whichever is lower, and corrected the law accordingly, the Act of 1924 providing:

> "The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be (A) the cost of such property (or, in the case of such property as is described in paragraph (1), (4) or (5), of subdivision (a), the basis as therein provided), or (B) the fair market value of such property as of March 1, 1913, *whichever is greater*" (sec. 204 (b)).

The learned Attorney General also said:

> "The Solicitor General . . . made the further *concession* that a loss on the complete transaction must have been sustained in order to make it a deductible loss."

But the Solicitor General could not *concede* a point that was not at issue in the case nor urged by his adversary! Statutory construction by "concession" of the Solicitor General is something quite novel in our jurisprudence. And this court apparently so regarded it, as is indicated by the fact that although it approved the Solicitor General's concession with respect to gains, it wholly ignored his uncalled for, gratuitous and obiter "concession" with respect to losses.

In the District Court in the *Goodrich* case, the Government insistently urged that since the act *was* being construed literally with respect to losses,—that is to say upon the basis of market value as of March 1, 1913,—it should likewise be literally construed with respect to gains. Expecting a similar contention in this court, the counsel for the taxpayer refuted the argument by pointing out that, with respect to losses, Congress was not subject to any restrictions and a literal construction could not, therefore, be objected to, but that, with respect to gains, the Constitution limited the power of Congress and the statute must be restricted to conform to the Constitution.

Wha' the taxpayer's counsel had to say in the *Goodrich* case with respect to losses was as follows (brief, p. 62):

> "The fact that the date of March first, 1913, is adopted in the Act of 1916 likewise for the purpose of determining a loss, that is, 'the basis for determining the amount of such loss sustained', is immaterial, because the allowance of the deduction of losses actually sustained is wholly a statutory concession, and Congress might, as it did in the Income Tax Act of 1913, c. 16, 38 Stat. 166, limit the losses allowable and exclude altogether as a deduction capital losses not sustained in carrying on a business or trade."

This language clearly left no room for inferring a *concession* of anything except the proposition that the rules with respect to gains and losses were entirely unrelated. In other words, there was no basis whatever for a *concession* by the Solicitor General with respect to losses unless it were the concession that the statute in respect of losses must be literally construed and not restricted.

VI.

THE PROVISIONS OF THE REVENUE ACT OF 1921 ALSO SUPPORT PLAINTIFF'S CONTENTIONS.

In November, 1921, the Revenue Act was amended by Congress in respect of income taxes so as among other things to provide that the basis for ascertaining both gain and loss in respect of property acquired before March 1, 1913, should thereafter in certain alternative cases be *cost* instead of *market value;* but the basis of *market value as of that date* was nevertheless retained as the general rule or basis in respect of all other cases of loss, including loss by casualty (Revenue Act of November 23, 1921, section 202 (a); 42 Stat. 227, 229).

For convenience of comparison, the provisions contained in the Revenue Acts of 1918 and 1921 are printed below in parallel columns so that the court may more readily perceive how much must be added by construction to the Act of 1918 in order to make it read and operate as now contended for by the Government. The Revenue Acts of 1916 and 1918 are in substance and effect the same, although in the Act of 1916 the respective provisions as to ascertaining gains and losses were in separate sections and deductible losses were limited "to an amount not exceeding the profits arising therefrom."

Revenue Act of 1918.	*Revenue Act of 1921.*
"Sec. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition	"Sec. 202. (a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property,

of property, real, personal or mixed, the basis shall be—

"(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

"(2) In the case of property acquired on or after that date, the cost thereof; or the inventory value, if the inventory is made in accordance with sec. 203."

real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property . . .

"(b) The basis for ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March 1, 1913, shall be the same as that provided by subdivision (a); [i. e., cost] but—

"(1) If its fair market price or value as of March 1, 1913, is in excess of such basis, the gain to be included in the gross income shall be the excess of the amount realized therefor over such fair market price or value;

"(2) If its fair market price or value as of March 1, 1913, is lower than such basis, the deductible loss is the excess of the fair market price or value as of March 1, 1913, over the amount realized therefor; and

"(3) If the amount realized therefor is more than such basis but not more than its fair market price or value as of March 1, 1913, or less than such basis but not less than such fair market price or value, no gain shall be included in and no loss deducted from the gross income."

It would surely be unreasonable and contrary to settled canons of interpretation to conclude that the distinctive and discriminating additions made in 1921, upon the recommendation of the Treasury Department as the public records show, wrought no change in the law as it existed prior to that date. To regard the amended law as accomplishing no change whatever is a clear strain on the common sense of the new provisions and supplemental language. On the contrary, such additional and amendatory language should be regarded as evidencing, and the reasonable presumption is, that in the judgment of Congress the Revenue Acts of 1916 and 1918 did not embrace the specific provision which the amended regulations grafted upon them and which the Act of 1921 expressly supplied.

Quite an analogous situation came before this court for adjudication in the case of *Smietanka* v. *First Trust & Savings Bank*, 257 U. S. 602, 606. The opinion of the court referred to the fact that the Treasury Department had not attempted for two years to collect any tax on income of the character then involved, that the Deputy Commissioner of Internal Revenue had ruled that the tax could not be levied, and that this ruling had been later changed by the Commissioner of Internal Revenue. Similarly in the case at bar under the Revenue Acts of 1916 and 1918, the Treasury Department for practically six years had directed taxpayers to deduct losses on the sole basis of the market value as of March 1, 1913; such were the instructions in the official forms, regulations and rulings, and the Commissioner of Internal Revenue later, in July, 1921, had changed the rule by amending Art. 1561 of Reg. 45.

Mr. Chief Justice Taft, speaking for the court, among other things, said:

> "This [the change of ruling by the Commissioner of Internal Revenue] seems to us to graft something on the statute that is not there. It is an amendment, and not a construction, and such an amendment was made in subsequent income tax laws, as we shall see. . . . It is obvious that, in the acts subsequent to that of 1913, Congress sought to make specific provision for the *casus omissus* in the earlier act. . . . In the later act, such property was expressly included. This was thought by the court to show at least a legislative doubt whether the earlier act included such property. This court said (p. 264) that it would have been easy for Congress to express a purpose to tax such property, but it had not done so. . . . In the next act, it did so. We cannot supply the omission in the earlier act."

In *Harriman* v. *Interstate Commerce Com.*, 211 U. S. 407, 422, Mr. Justice Holmes delivering the opinion of this court, said

> "The passage of the amendment indicates that without it the power would be wanting."

In *United States* v. *Bashaw*, 50 Fed. Rep. 749, 753-4,* the Circuit Court of Appeals for the Eighth Circuit among other things said:

> "The natural presumption is that the phraseology of the statute was changed in order to change its meaning. The very fact that the prior act is amended demonstrates the intent to change the pre-existing law, and the presumption must be that it was intended to change the statute in all the particulars touching which we find a material change in the language of the act."

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* Reversed upon another point.

See also, for persuasive instances of the application of this settled rule, *Rich* v. *Keyser,* 54 Pa. St. 86, 89; *Brown* v. *The German-American Title & Trust Co.,* 174 Pa. St. 443, 459; *State Highway Route No. 72,* 265 Pa. St. 369, 373; *United States* v. *A. J. Woodruff & Co.* (C. C. A. 2nd Cir.), 175 Fed. 776, 777; *Dailey* v. *Pugh* (Ind. App.), 131 N. E. 836; *State* v. *Beal,* 185 Ind. 192, and *Board of Education* v. *Boehm,* 102 Ohio St. 292.

The New York Court of Appeals had a similar question before it in the *Matter of Miller,* 110 N. Y. 216, 222, and discussed this rule of statutory construction. After pointing out that the so-called reason and equity of a statute could not control its plain language, although it might seem to the court that the legislature would have provided otherwise had its intention been directed to the effect then before the court, the court added:

> "Moreover, the fact that such provision was made by the statute of 1887 (Chap. 713), and the Act of 1885 amended accordingly, must be regarded as a legislative declaration that the law did not, as originally passed, embrace the provisions which the latter act supplies."

It appears from the Conference Report (p. 25) that the purpose of the 1921 provision discussed at p. 41, *supra,* was

> "to remove a doubt in existing law as to whether the basis of such a loss should be the value of the property on March 1, 1913, or the cost thereof."

Article 141 of Regulations 62, as promulgated under the Revenue Act of 1921, construes and contrasts this

provision with the other kindred terms of the Act of 1921 as follows:

> "LOSSES. Losses sustained during the taxable year and not compensated for by insurance or otherwise are fully deductible (except by non-resident aliens) if (a) incurred in a taxpayer's trade or business, or (b) incurred in any transaction entered into for profit, or (c) arising from fires, storms, shipwreck, or other casualty, or theft. They must usually be evidenced by closed and completed transactions.
>
> "*In the case of the sale of assets* the loss will be the difference between the cost thereof, less depreciation sustained and allowable as a deduction in computing net income, and the price at which sold or disposed of. See Article 1561. However, the loss which is deductible in the case where such property was acquired before March 1, 1913, and where its fair market value on that date was less than the cost thereof, is the difference between such value (less depreciation) and the price at which sold or disposed of. No loss is recognized in the case of property sold at less than cost minus depreciation but for more than its fair market value as of March 1, 1913, or for more than cost but less than the fair market value as of March 1, 1913. See Section 202 of the statute and articles 39-46 and 1561.
>
> "*When loss is claimed through the destruction* of property by fire, flood, or other casualty, the amount deductible will be the difference between the cost of the property, less proper adjustment for depreciation, and the salvage value thereof. In the case of property acquired before March 1, 1913, however, the deductible loss is the difference between the fair market value of the property as of that date, less proper adjustment for depreciation, and the salvage value thereof. In any event the loss should be reduced by the amount of any

insurance or other compensation received. See articles 49 and 261-263.

"*A loss on the sale of residential property* is not deductible unless the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit. Where a person gives away property, or is divested thereof by death, no realization of loss results therefrom."

Any suggestion that the language of section 202 of the Revenue Act of 1921 was intended to be interpretative rather than amendatory seems to be clearly negatived by the failure of the Act to indicate any such purpose. If Congress had intended the Act of 1921 to control with respect to the construction of the Act of 1918, it would certainly have so declared. Thus, when it had any such intent in mind, it knew how to indicate it, as is demonstrated in section 1331 of the same Act of 1921, where it laid down the rule for consolidation of returns under the 1917 law, as follows:

"Sec. 1331. (a) That Title II of the Revenue Act of 1917 shall be construed to impose the taxes therein mentioned upon the basis of consolidated returns of net income and invested capital in the case of domestic corporations and domestic partnerships that were affiliated during the calendar year 1917.

. . . .

(c) The provisions of this section are declaratory of the provisions of Title II of the Revenue Act of 1917."

It would, of course, have been as easy for Congress to have done the same with respect to section 202 of the Act of 1918, had it then had any such intent, and its silence reasonably indicates a contrary purpose.

Conclusion.

It is, therefore, submitted that the plain statutory standard of "fair market price or value of property" as of March 1, 1913, is the proper basis for determining deductible loss under the Revenue Act of 1918 as to property acquired before that date; and that consequently the judgment of the Circuit Court of Appeals was correct and should be affirmed.

New York, January 5, 1925.

William D. Guthrie,
Hugh Satterlee,
William R. Perkins,
Ralph B. Evans,
Of counsel for respondent-taxpayer.

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Supreme Court of the United States

October Term, 1924, No. 733.

BLAKELY D. McCAUGHN, United States Collector of Internal Revenue,

Petitioner,

versus

CHARLES H. LUDINGTON,

Respondent.

Certiorari to a judgment of the Circuit Court of Appeals for the Third Circuit.

APPENDIX TO BRIEF FOR RESPONDENT-TAXPAYER.

William D. Guthrie,
Hugh Satterlee,
William R. Perkins,
Ralph B. Evans,
Of counsel for respondent-taxpayer.

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Supreme Court of the United States

October Term, 1924, No. 733.

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Petitioner,

versus

Charles H. Ludington,
Respondent.

APPENDIX TO BRIEF ON BEHALF OF RESPONDENT-TAXPAYER.

This appendix to the brief on behalf of the respondent-taxpayer presents in convenient form the pertinent provisions of the Revenue Acts of 1916, 1918 and 1921, respectively, relating to the determination of gains and losses derived from sales or dealings in property, and also the material regulations of the Treasury Department for the administration of such provisions. The Revenue Acts of 1913 and 1917 are not included, because the former contained no provision for the determination of gain or loss on the sale of property acquired before March 1, 1913, and the latter did not modify the provisions of the Revenue Act of 1916 relating to such determination.

From the date of the enactment of the Revenue Act of 1916 on September 8, 1916, and from the date of the enactment of the Revenue Act of 1918 on February 24, 1919, until the decision of the Supreme Court in *Goodrich* v. *Edwards* (255 U. S. 527), on March 28, 1921, the uniform construction placed upon both of these Revenue Acts by the Treasury Department was that now asserted by the respondent-taxpayer and adjudged as correct by the Circuit Court of Appeals for the Third Circuit in the case at bar and by the Court of Claims in *Flannery* v. *United States.* But after the decision in *Goodrich* v. *Edwards,* and after the enactment of the Revenue Act of 1921 on November 23, 1921, until the present time the construction placed upon all three Acts by the Treasury Department has been that now advanced on behalf of the Government. It will be noted, therefore, that while the Revenue Act of 1916 was in force, and for most of the time that the Revenue Act of 1918 was in force, the departmental construction was one way, but that for the last few months that the Revenue Act of 1918 was in force, and since the Revenue Act of 1921 has been in force, the departmental construction has been directly to the contrary.

The immediate cause of this change of practical construction and application with respect to losses was the decision in *Goodrich* v. *Edwards.* This extension of the principle of that decision was at once challenged as erroneous, and the Treasury Department thereupon obtained an opinion of the Attorney General, dated August 23, 1922. This opinion presumably contains the reasons

for the present attitude of the Treasury Department, and a copy thereof is printed in this appendix at pp. 59-66.

The Respondent-Taxpayer is not now concerned with the construction of the Revenue Act of 1921 adopted by the Treasury Department. Its provisions are included simply for the purpose of comparison, in order to emphasize, by way of illustration, how they strikingly differ from the provisions of the Revenue Act of 1918.

Many informal rulings of the Internal Revenue Bureau, readily obtainable, were uniformly in accord with the formal regulations in force at the time, which regulations are herein printed at pp. 6-21, 24-46, 50-59.

STATUTES AND REGULATIONS.

A.

Revenue Act of 1916.

I. Statute

(1) As to gains by individuals:

"That, subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits, and income, derived from . . . sales, or dealings in property, whether real or personal, . . ." (Sec. 2 (a).)

"For the purpose of ascertaining the gain derived from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived." (Sec. 2 (c).)

(2) As to losses by individuals:

"For the purpose of the tax there shall be allowed as deductions— . . .

Fourth. Losses actually sustained during the year, incurred in his business or trade, or arising from fires, storms, shipwreck, or other casualty, and from theft, when such losses are not compensated for by insurance or otherwise: *Provided,* That for the purpose of ascertaining the loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property, as of March first nineteen hundred and thirteen shall be the basis for determining the amount of such loss sustained;

Fifth. In transactions entered into for profit but not connected with his business or trade, the losses actually sustained therein during the year to an amount not exceeding the profits arising therefrom." (Sec. 5 (a).)

(3) As to depreciation and depletion in the case of individuals:

"For the purpose of the tax there shall be allowed as deductions— . . .

Seventh. A reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade;

Eighth. (a) In the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow, but by the settled production or regular flow; (b) in the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof, which has been mined and sold during the year for which the return and computation are made, such reasonable allowance to be made in the case of both (a) and (b) under rules and regulations to be prescribed by the Secretary of the Treasury; *Provided*, That when the allowances authorized in (a) and (b) shall equal the capital originally invested, or in case of purchase made prior to March first, nineteen hundred and thirteen, the fair market value as of that date, no further allowance shall be made." (Sec. 5 (a).)

(4) As to gains and losses, including depreciation and depletion, in the case of corporations:

"For the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition by a corporation, joint-stock company or association, or insurance company, of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of

March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived or loss sustained." (Sec. 10 (a).)

"In the case of a corporation . . . such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources— . . .

Second. All losses actually sustained and charged off within the year and not compensated by insurance or otherwise, including a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade; (a) in the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow, but by the settled production or regular flow; (b) in the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof which has been mined and sold during the year for which the return and computation are made, such reasonable allowance to be made in the case of both (a) and (b) under rules and regulations to be prescribed by the Secretary of the Treasury: *Provided,* That when the allowance authorized in (a) and (b) shall equal the capital originally invested or in case of purchase made prior to March first, nineteen hundred and thirteen, the fair market value as of that date, no further allowance shall be made; . . ." (Sec. 12 (a).)

II. Regulations

(1) As to gains and losses:

1. "*Gifts.*—The fair market price or value of stock acquired by gift subsequent to March 1, 1913, is the basis for computing gain derived or loss sustained by the sale thereof. If acquired by gift prior to March 1, 1913, the fair market price or value as of that date is the basis for computation." (Reg. 33 (rev.), ¶41.)

2. "*Profit from the sale of stock.*—When stock is sold from lots purchased at different times and at different prices and the identity of the lots can not be determined as to dates of purchase, the stock sold shall be charged against the earliest purchases of such stock. The difference between cost and amount realized on the sale will be the profit to be accounted for as income if the purchase was on or after March 1, 1913. Profit derived from the sale of stock purchased prior to March 1, 1913, is the difference between the fair market price or value as of that date and the selling price." (Reg. 33 (rev.), ¶60.)

3. "In cases where securities or other assets, real, personal, or mixed, acquired prior to March 1, 1913, are disposed of during the year, the gain or loss thereon will be based upon the difference between the price at which disposed of and the fair market price or value of such assets as of March 1, 1913, or the difference between the price at which disposed of and the *cost* if acquired subsequent to that date." (Reg. 33 (rev.), ¶352.)

4. "*Art. 94. Income from damages recovered.*—When a corporation as a result of suit or otherwise secures payment for damages which it may have sustained, and the amount of such payment is in excess of an amount necessary to make good the damage or damaged property, the amount of such excess shall be considered and returned as income for the year in which received. If the entire or an estimated amount of the damage shall have been previously charged off and deducted from gross income, then the amount recovered shall be returned as income.

If the amount recovered is less than the damage sustained or less than an amount necessary to make good the damage, the difference between the actual amount of damage sustained and the amount recovered will be deductible as a loss." (Reg. 33 (rev.), ¶357.)

5. "*Art. 101. Income from sale of capital assets.*—If a corporation sells its capital assets in whole or in part, it will include in its gross income for the year in which the sale was made an amount equivalent to the excess of the sales price over the fair market price or value of such assets, as of March 1, 1913, if acquired prior to that date, or over cost if acquired subsequent to that date." (Reg. 33 (rev.), ¶366.)

6. "*Art. 109. Sale of patents.*—A corporation disposing of patents by sale, should determine the profit or loss arising therefrom, by computing the difference between the selling price and the cost, or value as of March 1, 1913, if acquired before that date. The apparent profit or loss should be increased or decreased, as the case may be, by the amounts deducted since March 1, 1913, as a return of capital invested in such patents." (Reg. 33 (rev.), ¶379.)

7. "*Art. 111. Exchange of property for stock.*—In cases wherein property was taken over in exchange for the capital stock of a corporation at a par value in excess of the fair market value of the property, and such property should be later sold, it will be necessary to ascertain as nearly as possible the fair market value of the property at the time it was taken over or as of March 1, 1913, if acquired before that date, and any excess over this ascertained fair market value at which the property is sold will be held to be profit or income to the corporation for the year in which the sale was made." (Reg. 33 (rev.), ¶381.)

8. "*Art. 112. Excess value.*—Similar action may be taken in cases wherein corporations acquire property prior to March 1, 1913, for a mere nominal sum and which had, as of March 1, 1913, a value greatly in excess of such nominal sum. A careful estimate of the fair market value of such property as of March 1, 1913, may be made and set up as the capital invested in the property, and if such property is thereafter disposed of at a

price in excess of such fair market value, the amount so in excess will be treated as income to be accounted for in preparing the return of annual net income of the year in which the property is sold. The value of the property fixed in the manner and for the purpose hereinbefore indicated will be subject to the approval of the Commissioner of Internal Revenue." (Reg. 33 (rev.), ¶382.)

9. "*Art. 116. Sale of capital assets.*—Section 10 of this title provides that for the purpose of ascertaining the gain derived from the sale or other disposition of property, real, personal, or mixed, acquired prior to March 1, 1913, the fair market price or value of such property, as of that date, shall be the basis for determining the amount of such gain derived.

This provision contemplates that all such gain realized and so ascertained, in cash or its equivalent, upon the sale or disposition of capital assets, shall be returned as gross income. In the case of property acquired subsequent to March 1, 1913, and later sold or disposed of, the difference between the cost and the selling price will be returned as income for the year in which the sale is made." (Reg. 33 (rev.), ¶¶ 387, 388.)

10. "*Sales on instalment plan.*—In cases wherein the property is sold on the installment plan, title passing at the time of sale, the gain to be returned as income for the year in which the sale was made will be the excess of the contract price over the fair market price or value as of March 1, 1913, if the property was acquired prior to that date, or of the contract price over the cost, if acquired subsequent to March 1, 1913. If the buyer forfeits his contract and fails to meet any of the payments contracted to be made, the selling corporation may deduct from its gross income as a loss, such proportion of the defaulted payments as was previously returned as gross income. (T. D. 2137.)" (Reg. 33 (rev.), ¶389.)

11. "In the case of real estate corporations, which purchase, or shall have purchased, a tract of land with a view to dividing it into lots or parcels of ground to be sold as such, the entire value, as of March 1, 1913, or cost, if acquired subsequent to that date, shall be equitably apportioned to the several lots or parcels, to the end that any gain derived from the sale of any such lots or parcels may be returned as income for the year in which the sale was made.

Real estate subdivisions.—This rule contemplates that there will be a measure of gain or loss in every lot or parcel sold, and does not contemplate that the capital invested in the entire tract shall be extinguished before any taxable income shall be returned. The sale of each lot or parcel will be treated as a separate transaction and the gain will be accounted for accordingly. If a loss results from the sale of capital assets, the amount of the loss to be deducted will be ascertained in a like manner as if a gain had been realized, and will be the amount by which the selling price is less than the value, as of March 1, 1913, or less than the cost, if acquired subsequent to that date, as the case may be. (T. D. 2077, 2137.)" (Reg. 33 (rev.), ¶¶391, 392.)

12. "*Art. 118. Sale to other corporation.*—In determining the profits realized or the loss sustained upon the sale of capital assets by one corporation to another, payment therefor being made in the stocks or bonds of the purchasing corporation, the profit or loss, as the case may be, from such sale will be ascertained upon the basis of the difference between the cost of such assets to the seller, in case they were acquired subsequent to March 1, 1913, or the fair market value as of March 1, 1913, if acquired prior to that date, and the fair cash value of the stock or bonds at the time the sale was made. (T. D. 2077, 2137.)" (Reg. 33 (rev.), ¶393.)

13. "*Art. 119. Sale by subsidiary to parent corporation.*—Where a subsidiary or other corporation sells or transfers its assets to a parent or other corporation, accepting in exchange therefor the stock or bonds of the purchasing corporation, the question of gain or loss resulting from this transaction will be determined upon the basis of the difference between the cost or market value as above indicated of the assets sold and the actual value of the stock or bonds given in exchange therefor. Any gain or loss thus ascertained as resulting from such a transaction will be added to or deducted from the entire gross income, as the case may be, of the selling corporation in the year in which the capital assets were sold. (T. D. 2077, 2137.)" (Reg. 33 (rev.), ¶394.)

14. "If, however, one corporation buys the assets of another and issues direct to the selling company its own capital stock in payment for the assets acquired, the transaction will be treated by the selling company as a sale of its assets, and the question as to whether profit or loss results from the sale will depend upon whether or not the value of the stock taken in payment for the assets is in excess of the fair market price or value as of March 1, 1913, of the assets sold or of their cost accordingly as they were acquired by the selling company prior or subsequent to that date.

If the value of the stock is so in excess, the amount of such excess will be taxable income for the year in which the assets were sold and must be so returned.

If the excess over value as of March 1, 1913, or over cost, as the case may be, includes any surplus earned since March 1, 1913, upon which the income tax has been paid, the excess or profits resulting from the sale may be reduced by the amount of such tax-paid surplus.

If the purchasing corporation takes over all the assets including accounts receivable, bills receivable, surplus, etc., of the selling corporation and assumes its liabilities, the amount so assumed will

be considered a part of the purchase price, and to the extent that the entire purchase price exceeds the cost or value, as of March 1, 1913, as the case may be of the assets disposed, income will accrue to the selling company." (Reg. 33 (rev.), ¶¶411-414.)

15. "*Art. 147. When deductible.*—The deduction for losses must represent losses not compensated for by insurance or otherwise and which were charged off and actually sustained within the year as evidenced by closed and completed transactions.

In the case of the sale of assets—real, personal, or mixed—the loss will be the difference between the cost thereof, or the value as of March 1, 1913, if acquired before that date, and the price at which disposed of. When the loss is claimed through the destruction of property by fire, flood, or other casualty the amount deductible will be the difference between the value as of March 1, 1913, or the cost of the property and the salvage value thereof, including in the latter value the amount, if any, that has been or should have been set aside and deducted in the current or previous years from gross income on account of depreciation and which has not been paid out in making good the depreciation sustained." (Reg. 33 (rev.), ¶458.)

16. "*Art. 157. Sale of patents.*—A corporation disposing of patents by sale should determine the profit or loss arising therefrom by computing the difference between the selling price and the value as of March 1, 1913, if acquired prior to that date, or between the selling price and the cost, if acquired subsequent to that date. The profit or loss thus ascertained should be increased or decreased, as the case may be, by the amounts deducted on account of depreciation of such patents since March 1, 1913, or since the date of purchase if acquired subsequent to that date." (Reg. 33 (rev.), ¶475.)

17. "*Good Will. Art. 167.*—'Good will' represents the value attached to a business over and above the value of the physical property, and is such an intangible asset that it is not subject to wear and tear, and no claim for depreciation in connection therewith can be allowed. Any loss resulting from or on account of an investment in 'good will' can be determined only when the property or business to which the good will attaches is sold or disposed of, in which case the profit or loss will be determined upon the basis of the value of the assets including good will if acquired prior to March 1, 1913, or their cost if acquired subsequent to that date." (Reg. 33 (rev.) ¶494.)

18. "*Art. 168. No deduction for depreciation of good will, trade-marks, and trade brands.*—No deduction will be allowed for the depreciation of good will, trade-marks, and trade brands. If such assets shall have been purchased at a determined price and shall be later sold at a price less than such cost or less than their determined fair market value as of March 1, 1913, if acquired prior to that date, the amount by which the selling price is less than the cost or value, as the case may be, will be a loss deductible from the gross income of the year in which such assets were sold." (Reg. 33 (rev.), ¶495.)

19. "*Sale of capital assets.*—For the purpose of ascertaining the gain or loss from sale or other disposition of ledger assets acquired prior to March 1, 1913, the fair market price or value of such assets as of March 1, 1913, shall be the basis for determining the amount of such gain or loss to be accounted for in the return of the year in which the assets are sold. If acquired subsequent to March 1, 1913, then the profit or loss to be returned or claimed will be the difference between the cost and the selling price." (Reg. 33 (rev.), ¶679.)

20. "*Losses actually sustained.*—Losses deductible (other than policy payments) must be distinguished from depreciation or allowances for exhaustion, wear and tear. The losses must be absolute, complete, actually sustained during the year, and charged off on the books of the company, and if the losses result from the sale of assets acquired prior to March 1, 1913, such losses shall be ascertained by taking the difference between the fair market price or value as of March 1, 1913, and the selling price. If the assets were acquired subsequent to March 1, 1913, the loss will be the amount by which the selling price is less than the *cost*." (Reg. 33 (rev.), ¶691.)

21. "The following propositions of law, stated for the information and guidance of internal-revenue officers and others concerned, are expressed or implied in the recent decisions of the Supreme Court of the United States in United States *v.* Biwabik Mining Co. (T. D. 2721), Goldfield Consolidated Mines Co. *v.* Scott (T. D. 2722), Doyle *v.* Mitchell Bros. Co. (T. D. 2723), Hays *v.* Gauley Mountain Coal Co. (T. D. 2724), United States *v.* Cleveland, Cincinnati, Chicago & St. Louis Railway Co. (T. D. 2725), William E. Peck & Co. (Inc.) *v.* Lowe (T. D. 2726), Lynch *v.* Turrish (T. D. 2729), Southern Pacific Co. *v.* Lowe (T. D. 2730), Lynch *v.* Hornby (T. D. 2731), and Peabody *v.* Eisner (T. D. 2732): . . .

(*b*) In order to determine whether there has been gain or loss on a sale, and the amount of the gain, if any, in general under all three acts, an amount must be withdrawn from the gross proceeds sufficient to restore the cost of the property or the capital value* that existed at the commencement of the period under consideration (either Jan. 1, 1909, or Mar. 1, 1913). . . .

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* This wording taken from *Doyle* v. *Mitchell Bros. Co.*, 247 U. S. 179, 185.

For the purpose of the act of 1916, however, the fair market price or value as of March 1, 1913, to be ascertained in any practicable manner, is the statutory basis for determining the amount of gain on a sale of property acquired before that date. See regulations No. 31, T. D. 1578, T. D. 1588, T. D. 1606 (37, 71), T. D. 1675 (36, 55, 69), T. D. 1742 (42, 62, 86); articles 4, 90, 91, 92, 93, 101, 109, 111, 112, and 116 of regulations No. 33, revised, and T. D. 2649. Doyle *v.* Mitchell Bros. Co., Hays *v.* Gauley Mountain Coal Co., United States *v.* Cleveland, Cincinnati, Chicago & St. Louis Railway Co." (T. D. 2740.)

(2) As to depreciation and depletion:

1. "*Depletion—Timber.*—In the case of timberlands, the fair market price or value of timber standing March 1, 1913, or the cost of the timber where the purchase was made subsequent to March 1, 1913, will be the basis for calculation of depletion, and this value as of March 1, 1913, or cost when subsequently purchased, is not to be exceeded for purposes of deduction in returns of income. The whole of such value is to be distributed over the entire amount of standing timber on these respective dates. See Art. 173 of these regulations for rule of calculation." (Reg. 33 (rev.), ¶125.)

2. "*Art. 163. Value to be estimated, when.*—In determining the cost of the real estate upon which depreciable property is located it frequently occurs that no segregation is made of the cost of buildings as separate and distinct from the cost of the ground upon which such buildings stand. In such cases where the actual cost of the buildings or improvements at the time they were taken over by the corporation can not be definitely determined, it will be sufficient for the purpose of determining the rate of depreciation to be used in computing the amount which will be deductible from gross income to estimate the actual value

at the time acquired of buildings or improvements if acquired after March 1, 1913, or the fair market price or value as of that date if the property was acquired prior to March 1, 1913, the value in either case to be reduced by the amount of depreciation previously sustained. (T. D. 2137, 2152.)" (Reg. 33 (rev.), ¶488.)

3. "*Art. 170.* Sections 5 and 12 of the act of September 8, 1916, as amended by the act of October 3, 1917, authorize individuals and corporations owning and operating gas or oil properties, to deduct from gross income——

'A reasonable allowance . . . for actual reduction in flow and production, . . . provided that when the allowance authorized . . . shall equal the capital originally invested, or in case of purchase made prior to March 1, 1913, the fair market value as of that date, no further allowance shall be made.'

The essence of this provision of law is that the owner or operator of this character of properties shall secure through an aggregate of annual depletion deductions, the return of the amount of capital actually invested, or an amount not in excess of the fair market value as of March 1, 1913, of the properties owned prior to that date." (Reg. 33 (rev.), ¶¶497-499.)

4. "In the case of the operating fee owner, the amount returnable through depletion deductions is the fair market value of the property (exclusive of the cost of physical property) as of March 1, 1913, if acquired prior to that date, or the actual cost of the property if acquired subsequent to that date, plus, in either case, the cost of development (other than the cost of physical property incident to such development) up to the point at which the income from the developed territory equals or exceeds the deductible expenses." (Reg. 33 (rev.), ¶501.)

5. "In the case of either an owner or lessee it will be required that an estimate, subject to the

approval of the Commissioner of Internal Revenue, shall be made of the probable quantity of oil or gas contained in or to be recovered from the territory with respect to which the investment is made. The invested capital (value as of Mar. 1, 1913, or cost, if acquired subsequent to that date, plus the cost of development, other than cost of physical property, up to the point of expense-paying production, in the case of an owner, and the amount actually paid for the lease plus cost of development, other than cost of physical property, up to the same point, in the case of a lessee) will be divided by the number of units of oil or gas so estimated to be contained in or to be recovered from the territory, and the quotient will be the per unit cost or amount of capital invested in each unit recoverable. This quotient, or per unit cost, when multiplied by the number of units removed from the territory during any one year, will determine the amount which may be allowably deducted from the gross income of that year on account of depletion of assets or as a return of invested capital until the total of such deductions shall equal the capital invested." (Reg. 33 (rev.), ¶504.)

6. "If the operator is the owner of the fee the value determined and set up as of March 1, 1913, or the cost of the property if acquired subsequent to that date, or, if the operator is a lessee, the amount actually paid for the lease, plus, in the case of both owner and lessee, the cost of subsequent development, exclusive of physical property, if such cost is capitalized, will be the basis for determining the depletion deduction or the deduction for return of capital for all subsequent years during the continuance of the ownership under which the value was fixed or by which the investment was made, and during such ownership there can be no revaluation for the purpose of this deduction if it should be found that the quantity of oil or gas in the property was underestimated at

the time the value was fixed or the property was acquired, or at the time the lease contract was entered into or purchased." (Reg. 33 (rev.), ¶508.)

7. "To each return made by an individual or corporation owning and operating oil or gas properties there should be attached a statement showing—

(1) (*a*) The fair market value of the property (exclusive of machinery, equipment, etc.) as of March 1, 1913, if acquired prior to that date, or (*b*) the actual cost of the property if acquired subsequent to that date." (Reg. 33 (rev.), ¶¶512, 513.)

8. "*Art. 172.* If the property was acquired by purchase or otherwise (other than by lease) prior to March 1, 1913, the amount of invested capital which may be extinguished through annual depletion deductions from gross income will be the fair market value of the mine property so acquired, as of March 1, 1913. The value contemplated herein as the basis for depletion deductions authorized by this title must not be based upon the assumed saleable value of the output under current operative conditions, less cost of production, for the reason that the value so determined would comprehend the profits to be realized from operation of the property." (Reg. 33 (rev.), ¶530.)

9. "In cases wherein the quantity of the mineral deposit in the mine prior to March 1, 1913, can not be estimated with any degree of accuracy, it will be necessary, if depletion deductions are to be taken, for the individual or corporation owning the deposits, with the best information available, to arrive at the fair market value of the property as of March 1, 1913; that is, its fair cash value en bloc, if such value is believed to be other than its original cost, which value, during the period of the ownership under which it was determined shall be final and shall be charged to the property account

as hereinbefore indicated, and then, on the basis of the most probable number of units in the property, the per unit value shall be determined as the basis for computing annual depletion allowances, this method and allowances to be continued until, but not beyond, the time when the value as of March 1, 1913, shall have been extinguished." (Reg. 33 (rev.), ¶538.)

10. "*Art. 173.* Corporations owning timber land and logging off the timber and manufacturing it into lumber, will, if the timber was acquired prior to March 1, 1913, be permitted to exclude from gross income either through a deduction from gross receipts or through a charge into the cost of manufacturing the timber into lumber, an amount equivalent to the fair market price or value of the standing timber as of March 1, 1913." (Reg. 33 (rev.), ¶547.)

11. "Section 12 (a) of the act of September 8, 1916, as amended, to which section 5 (a) is similar, provides that net income shall be ascertained by deducting from gross income, among other things:

> Second. All losses actually sustained and charged off within the year and not compensated by insurance or otherwise, including a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade.

A reasonable allowance for the wear and tear of property arising out of its use or employment in the business or trade is to be based on the cost of such property or on its fair market price or value as of March 1, 1913, if acquired prior thereto. In the absence of proof to the contrary, it will be assumed that such value as of March 1, 1913, is the cost of the property, less depreciation up to that date.

This decision is supplemental to articles 159 to 169, inclusive, of regulations No. 33 (revised), which to any necessary extent are modified accordingly." (T. D. 2754.)

III. Instructions contained in return forms

(1) For the year 1916:

"C. Profit from sale of land, buildings, and other property, real or personal.

1. Kind of Property (See instructions on page 2)	2. Year acquired	3. Sale Price	4. Cost

Total profit (Total of column 3 minus total of column 4)."

"C. Profit from sale of land, buildings, and other property, real or personal.

"*Kind of property.* Describe the property as definitely as you can in a word or two, as 'farm', 'dwelling', 'stocks', 'bonds', etc.

"*Cost.* Enter the original cost of the property, (or, if it was acquired before March 1, 1913, the fair market value on that date) plus the cost of any permanent improvements since made, less any deductions claimed in this return or in previous returns on account of wear and tear (depreciation) or depletion.

"If total cost of all property sold exceeded total sale price, the loss will not be allowed as a deduction unless the transactions formed part of your regular business."

(2) For the year 1917:

"C. PROFITS FROM SALE OF REAL ESTATE, STOCKS, BONDS, AND OTHER PROPERTY.

Kind of roperty	2. Year acquired	3. Name and address of purchaser or broker.	4. Sale price	5. Original cost or market value Mar. 1, 1913	6. Cost of subsequent improvements, if any	7. Depreciation previously allowed.

tals,

t profits from sales (total of columns 4 and 7 minus totals of columns 5 and 6)

"C. PROFITS FROM SALE OF REAL ESTATE, STOCKS, BONDS, AND OTHER PROPERTY.

"COST. If the property was acquired before March 1, 1913, report the estimated market value on that date instead of the cost and explain the basis of your estimate.

"Expenses incidental to the purchase of property may be included in the cost if never claimed in income tax returns as a deduction from income.

"LOSSES. If total cost of all property sold exceeded total sale price, the loss will not be allowed as a deduction unless the sales out of which the loss arose were connected with your regular business. If a deduction is claimed on account of losses reported under C, explain what connection the sales had with your regular business and enter the amount of the loss under J, 'Other deductions'".

B.

Revenue Act of 1918.

I. Statute

(1) As to gains and losses:

"That for the purposes of this title . . . the term 'gross income'—

(a) Includes gains, profits, and income derived from . . . sales, or dealings in property, whether real or personal, . . ." (Secs. 213 (a) and 233 (a).)

"That in computing net income there shall be allowed as deductions [in the case of an individual]: . . .

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;

(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; but in the case of a nonresident alien individual only as to such transactions within the United States;

(6) Losses sustained during the taxable year of property not connected with the trade or business (but in the case of a nonresident alien individual only property within the United States) if arising from fires, storms, shipwreck, or other casualty, or from theft, and if not compensated for by insurance or otherwise;" (Sec. 214 (a).)

"That in computing the net income of a corporation . . . there shall be allowed as deductions: . . .

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise;" (Sec. 234 (a).)

"That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

(2) In the case of property acquired on or after that date, the cost thereof; or the inventory value, if the inventory is made in accordance with section 203." (Sec. 202 (a).)

"When in the case of any such reorganization, merger or consolidation the aggregate par or face value of the new stock or securities received is in excess of the aggregate par or face value of the stock or securities exchanged, a like amount in par or face value of the new stock or securities received shall be treated as taking the place of the stock or securities exchanged, and the amount of the excess in par or face value shall be treated as a gain to the extent that the fair market value of the new stock or securities is greater than the cost (or if acquired prior to March 1, 1913, the fair market value as of that date) of the stock or securities exchanged." (Sec. 202 (b).)

(2) As to depreciation and depletion:

"That in computing net income there shall be allowed as deductions: . . .

(8) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence; . . .

(10) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted: *Provided,*

That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: *Provided further,* That in the case of mines, oil and gas wells, discovered by the taxpayer, on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of the discovery, or within thirty days thereafter; . . ." (Secs. 214 (a) and 234 (a).)

II. Regulations before March 28, 1921

(1) As to gains and losses:

1. "*Art. 39. Sale of stock and rights.*—When shares of stock in a corporation are sold from lots purchased at different times and at different prices and the identity of the lots can not be determined, the stock sold shall be charged against the earliest purchases of such stock. The excess of the amount realized on the sale over the cost of the stock, or its fair market value as of March 1, 1913, if purchased before that date, will be the profit to be accounted for as income. In the case of stock received as a stock dividend, whether or not paid out of earnings or profits accrued since February 28, 1913, and in the case of stock in respect of which any such dividend was paid, the cost of each share of such stock shall be ascertained as specified in article 1547. Where common stock is received as a bonus with the purchase of preferred stock or bonds, the total purchase price shall be fairly apportioned between the stock and securities purchased for the purpose of determining the portion of the consideration attributable to each class of stock or securities and so representing its cost, but if that should be impracticable

in any case, no profit on any subsequent sale of any part of the stock or securities will be realized until out of the proceeds of sales shall have been recovered the total cost. See article 1565. The entire amount realized from the sale of rights to subscribe for stock is income." (Reg. 45.)

2. "*Art. 40. Sale of patents and copyrights.*—A taxpayer disposing of patents or copyrights by sale should determine the profit or loss arising therefrom by computing the difference between the selling price and the value as of March 1, 1913, if acquired prior to that date, or between the selling price and the cost, if acquired subsequently to that date. The profit or loss thus ascertained should be increased or decreased, as the case may be, by the amounts deducted on account of depreciation of such patents or copyrights since February 28, 1913, or since the date of acquisition if subsequently thereto. See article 167." (Reg. 45.)

3. *Art. 41. Sale of good will.*—Any profit or loss resulting from an investment in good will can be taken only when the business, or a part of it, to which the good will attaches is sold, in which case the profit or loss will be determined upon the basis of the cost of the assets, including good will, or their fair market value as of March 1, 1913, if acquired prior thereto. If nothing was paid for good will acquired after February 28, 1913, no deductible loss is possible, although, on the other hand, upon the sale of the business there may be a profit. It is immaterial that good will may never have been carried on the books as an asset, but the burden of proof is on the taxpayer to establish the cost or fair market value on March 1, 1913, of the good will sold." (Reg. 45.)

4. "*Art. 43. Sale of real estate in lots.*—Where a tract of land is purchased with a view to dividing it into lots or parcels of ground to be sold as such, the entire fair market value as of

March 1, 1913, or the cost, if acquired subsequently to that date, shall be equitably apportioned to the several lots or parcels and made a matter of record in the books of the taxpayer, to the end that any gain derived from the sale of any such lots or parcels may be returned as income for the year in which the sale was made. This rule contemplates that there will be a measure of gain or loss in every lot or parcel sold, and not that the capital invested in the entire tract shall be extinguished before any taxable income shall be returned. The sale of each lot or parcel will be treated as a separate transaction and the gain or loss will be accounted for accordingly." (Reg. 45.)

5. "*Art. 87. Income accruing prior to March 1, 1913.*—Property held by the taxpayer on March 1, 1913, is capital. Included in this capital are all claims, whether evidenced by writing or not, and all interest which had accrued thereon before that date. Interest accruing on or after that date is taxable income. Where an interest-bearing claim contracted prior to March 1, 1913, is paid in whole or in part after that date, any gain derived from the conversion of the claim into money is taxable. The amount of such gain is the excess of the proceeds of the claim (both principal and interest), exclusive of any interest accrued since February 28, 1913, already returned as income, over the fair market value of the claim as of March 1, 1913 (both principal and interest then accrued). In the case of an insurance policy its surrender value as of March 1, 1913, may be used as a basis for the purpose of ascertaining the gain derived from the sale or other disposition of such policy. Where services were rendered prior to March 1, 1913, but paid for thereafter, the amount received is taxable income to the extent of the excess of such amount over the fair market value on March 1, 1913, of the principal of the claim and any interest which had then accrued

A claim for the purpose of this article means a right existing unconditionally on March 1, 1913, and then assignable, whether presently payable or not. Interest does not, of course, include dividends on corporate stock. See section 201 of the statute and articles 1541-1549." (Reg. 45.)

6. "*Art. 141. Losses.*—Losses sustained during the taxable year and not compensated for by insurance or otherwise are fully deductible (except by nonresident aliens) if (*a*) incurred in the taxpayer's trade or business, or (*b*) incurred in any transaction entered into for profit, or (*c*) arising from fires, storms, shipwreck or other casualty, or from theft. They must usually be evidenced by closed and completed transactions. In the case of the sale of assets the loss will be the difference between the cost thereof, less depreciation sustained since acquisition, or the fair market value as of March 1, 1913, if acquired before that date, less depreciation since sustained, and the price at which they were disposed of. See section 202 of the statute and articles 39-46 and 1561. When the loss is claimed through the destruction of property by fire, flood or other casualty, the amount deductible will be the difference between the cost of the property or its fair market value as of March 1, 1913, and the salvage value thereof, after deducting from the cost or value as of March 1, 1913, the amount, if any, which has been or should have been set aside and deducted in the current year and previous years from gross income on account of depreciation and which has not been paid out in making good the depreciation sustained. But the loss should be reduced by the amount of any insurance or other compensation received. See articles 49 and 50. A loss in the sale of an individual's residence is not deductible. Losses in illegal transactions are not deductible." (Reg. 45.)

7. "*Art. 143. Loss of useful value.*—When through some change in business conditions the

usefulness in the business of some or all of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in the business, he may claim as a loss for the year in which he takes such action the difference between the cost or the fair market value as of March 1, 1913, of any asset so discarded (less any depreciation allowances) and its salvage value remaining. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property must be prematurely discarded, as, for example, where machinery or other property must be replaced by a new invention, or where an increase in the cost of or other change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized. It does not apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be charged off on the books and fully explained in returns of income. But see articles 181-188." (Reg. 45.)

8. "*Art. 144. Shrinkage in securities and stocks.*—A person possessing securities, such as stocks and bonds, can not deduct from gross income any amount claimed as a loss on account of the shrinkage in value of such securities through fluctuation of the market or otherwise. The loss allowable in such cases is that actually suffered when the securities mature or are disposed of.

See, however, article 154. In the case of banks or other corporations which are subject to supervision by State or federal authorities, and which in obedience to the orders of such supervisory officers charge off as losses amounts representing an alleged shrinkage in the value of property, the amounts so charged off do not constitute allowable deductions. The foregoing applies only to owners and investors, and not to dealers in securities, as to whom see article 1585. However, if stock of a corporation becomes worthless, its cost or its fair market value as of March 1, 1913, if acquired prior thereto, may be deducted by the owner in the taxable year in which the stock was ascertained to be worthless and charged off, provided a satisfactory showing of its worthlessness be made as in the case of bad debts. See article 151." (Reg. 45.)

9. "*Art. 545. Sale of capital assets.*—Where property is acquired and later sold for a higher price, the gain on the sale is income. If, however, the property was acquired before March 1, 1913, only such portion of the gain as accrued subsequently to February 28, 1913, is taxable. Where, then, a corporation sells its capital assets in whole or in part, it shall include in its gross income for the year in which the sale was made the amount of the excess of the sales price over the fair market value of such assets as of March 1, 1913, if acquired prior to that date, or over their cost if acquired subsequently to that date. In every case, however, in ascertaining the gain, the cost of the assets, or the fair market value as of March 1, 1913, of the assets acquired prior thereto, should first be reduced by the amount of any charges for depreciation, depletion and other losses which have been or should have been made. If the purchaser takes over all the assets and assumes the liabilities, the amount so assumed is part of the purchase price. See also article 563. If the sale is made for stock of another corporation, the rules

contained in section 202 of the statute and in articles 1561-1570 are particularly applicable." (Reg. 45.)

10. "*Art. 563. Sale of capital stock, bonds and capital assets.*—A corporation sustains no deductible loss from the sale of its capital stock. See article 542. If it sells its bonds at a discount, the amount of such discount is treated as interest paid, and if it retires its bonds at a price in excess of the issuing price, such excess may usually be deducted as expense. See articles 544 and 848. If the corporation sells its capital assets for less than their cost or fair market value as of March 1, 1913, the loss sustained is deductible. See article 545." (Reg. 45.)

11. "*Art. 1561. Basis for determining gain or loss from sale.*—For the purpose of ascertaining the gain or loss from the sale or exchange of property the basis is (*a*) its fair market price or value as of March 1, 1913, if acquired prior thereto, or (*b*), if acquired on or after that date, its cost or its approved inventory value. In both cases proper adjustment must be made for any depreciation or depletion sustained. What the fair market price or value of property was on March 1, 1913, is a question of fact to be established by any evidence which will reasonably and adequately make it appear. As to inventories see section 203 of the statute and articles 1581-1585. The fair market value as of March 1, 1913, has no bearing on the determination of the invested capital of a corporation for the purpose of the war profits and excess profits tax. See section 326 and article 831." (Reg. 45.)

12. "*Art. 1562. Sale of property acquired by gift or bequest.*—In the case of property acquired by gift, bequest, devise or descent the basis for computing gain or loss on a sale is the fair market price or value of the property at the date of acquisition or as of March 1, 1913, if acquired prior

thereto. For the purpose of determining the profit or loss from the sale of property acquired by bequest, devise or descent since February 28, 1913, its value as appraised for the purpose of the federal estate tax, or in the case of estates not subject to that tax its value as appraised in the State court for the purpose of State inheritance taxes, should be deemed to be its fair market value when acquired. See section 213 (b) (3) of the statute and article 73." (Reg. 45.)

13. "*Art. 1564. Determination of gain or loss from exchange of property.*—(*a*) The amount of income derived in the case of an exchange of property, as of stock for a bond, is the excess of the fair market value at the time of exchange of the bond received in exchange over the original cost of the stock exchanged for it, or over the fair market price or value of such stock as of March 1, 1913, if acquired before that date. The amount of income derived from a subsequent sale of the bond for cash is the excess of the amount so received over the fair market value of such bond when acquired in exchange for the stock. (*b*) On the other hand, if the property received in exchange is substantially the same property or has no market value, then no gain or loss is realized, but the new property is to be regarded as substituted for the old and upon a sale of the new property the amount of income derived is the excess of the amount so received over the cost or fair market value as of March 1, 1913, of the old." (Reg. 45.)

14. "*Art. 1565. Exchange for different kinds of property.*—(*a*) If property is exchanged for two different kinds of property, such as bonds and stock, the bonds having a market value and the stock none, the value of the bonds is to be compared with the cost or fair market value as of March 1, 1913, of the original property, as the case may be. If the market value of the bonds is less than such cost or value, the difference represents the cost of the stock. If the market value of the

bonds is greater than such cost or value, the difference is taxable income at the time of the exchange and whenever sold the entire proceeds of the stock will be taxable. (*b*) If property is exchanged for two different kinds of property, such as bonds and stock, neither having a market value, the cost or fair market value as of March 1, 1913, of the original property should be apportioned, if possible, between the bonds and stock for the purpose of determining gain or loss on subsequent sales. If no fair apportionment is practicable, no profit on any subsequent sale of any part of the bonds or stock is realized until out of the proceeds of sales shall have been recovered the entire cost or fair market value as of March 1, 1913, of the original property." (Reg. 45.)

15. "*Art. 1566. Exchange of property and stock.*—Where property is transferred to a corporation in exchange for its stock, the exchange constitutes a closed transaction and the former owner of the property realizes a gain or loss if the stock has a market value, and such market value is greater or less than the cost or the fair market value as of March 1, 1913 (if acquired prior thereto), of the property given in exchange. For the rule applicable where a corporation in connection with a reorganization, merger, or consolidation, exchanges property for stock, see article 1567." (Reg. 45, as amended Sept. 26, 1919.)

16. "*Art. 1569. Exchange of stock for other stock of greater par value.*—If in the case of any reorganization, merger, or consolidation the aggregate par or face value of the new stock or securities received is in excess of the aggregate par or face value of the stock and securities exchanged, income will be realized from the transaction by the recipients of the new stock or securities to an amount limited by (*a*) the excess of the par or face value of the new stock or securities over the par or face value of the old and (*b*) the excess of the

fair market value of the new stock or securities over the cost or fair market value as of March 1, 1913, of the old. In other words, the taxable profit will be (*a*) or (*b*), whichever is less. Upon a subsequent sale of the new stock or securities their cost to the taxpayer will be the cost or fair market value as of March 1, 1913, of the old stock and securities, plus the profit taxed on the exchange." (Reg. 45.)

(2) As to depreciation and depletion:

1. "*Art. 161. Depreciation.*—A reasonable allowance for the exhaustion, wear and tear and obsolescence of property used in the trade or business may be deducted from gross income. For convenience such an allowance will usually be referred to as covering depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear or obsolescence. The proper allowance for such depreciation of any property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a consistent plan by which the aggregate of such amounts for the useful life of the property in the business will suffice, with the salvage value, at the end of such useful life to provide in place of the property its cost, or its value as of March 1, 1913, if acquired by the taxpayer before that date. See further articles 839 and 844." (Reg. 45.)

2. "*Art. 201. Depletion of mines, oil and gas wells.*—A reasonable deduction from gross income for the depletion of natural deposits and for the depreciation of improvements is permitted, based (*a*) upon cost, if acquired after February 28, 1913, or (*b*) upon the fair market value as of March 1, 1913, if acquired prior thereto, or (*c*) upon the fair market value within 30 days after the date of discovery in the case of mines, oil and gas wells discovered by the taxpayer after February 28, 1913, where the fair market value is materially dispro-

portionate to the cost. The essence of this provision is that the owner of such property, whether it be a leasehold or freehold, shall secure through an aggregate of annual depletion and depreciation deductions a return of the amount of capital invested by him in the property, or in lieu thereof an amount equal to the fair market value as of March 1, 1913, of the properties owned prior to that date, or an amount equal to the fair market value within 30 days after the date of discovery of mines, oil or gas wells discovered by the taxpayer on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost; plus in any case the subsequent cost of plant and equipment (less salvage value) and underground and overground development, which is not chargeable to current operating expense, but not including land values for purposes other than the extraction of minerals. Operating owners, lessors and lessees are entitled to deduct an allowance for depletion, but a stockholder in a mining or oil or gas corporation is not. See further articles 839 and 844." (Reg. 45.)

III. Regulations after March 28, 1921

(1) As to gains and losses:

"Articles 39, 40, 41, 43, 48, 49, 87, 141, 143, 144, 545, 563, 1543, 1547, 1548, 1549, 1561, 1562, 1564, 1565, 1566, 1568, 1569, and 1570 of Regulations No. 45 (1920 ed.) are hereby amended in order that the rule announced by the Supreme Court in the cases of Goodrich *v.* Edwards and Brewster *v.* Walsh, respecting the basis for the determination of taxable gain or deductible loss in the case of property acquired prior to March 1, 1913, and sold or disposed of subsequent thereto, may be incorporated therein. The amendments are merely for the purpose of such incorporation and make no attempt to correct any of the regulations in any respect other than the one necessitated by those cases. The amendments are as follows:

ART. 39. *Sale of stock and rights.*—When shares of stock in a corporation are sold from lots purchased at different dates and at different prices and the identity of the lots can not be determined the stock sold shall be charged against the earliest purchases of such stock. The excess of the amount realized on the sale over the cost of the stock will constitute gain. However, the gain which is taxable in the case where the stock was acquired before March 1, 1913, when its fair market value as of that date is in excess of its cost, is the excess of the amount realized by the sale over such value. No gain is recognized when stock is sold at more than its cost but at less than its fair market value as of March 1, 1913. In the case of stock in respect of which any stock dividend was paid, the cost of each share of such stock shall be ascertained as specified in article 1547. Where common stock is received as a bonus with the purchase of preferred stock or bonds, the total purchase price shall be fairly apportioned between such common stock and the securities purchased for the purpose of determining the portion of the cost attributable to each class of stock or securities, but if that should be impracticable in any case, no profit on any subsequent sale of any part of the stock or securities will be realized until out of the proceeds of sales shall have been recovered the total cost. See article 1565 as amended. The entire amount realized from the sale of rights to subscribe for stock is income.

ART. 40. *Sale of patents and copyrights.*—A taxpayer disposing of patents or copyrights by sale should determine the profit or loss arising therefrom by computing the difference between the selling price and the cost. The taxable income in the case of patents or copyrights acquired prior to March 1, 1913, should be ascertained in accordance with the provisions of article 1561 as amended. The profit or loss thus ascertained should be increased or decreased, as the case may

be, by the amounts deducted on account of depreciation of such patents or copyrights since February 28, 1913, or since the date of acquisition if subsequent thereto. See article 167.

Art. 41. *Sale of good will.*—Any profit or loss resulting from a sale of good will can be taken only when the business, or a part of it, to which the good will attaches is sold, in which case the profit or loss will be determined upon the basis of the cost of the assets, including good will. If the good will was acquired prior to March 1, 1913, the taxable gain or deductible loss should be ascertained in accordance with the provisions of article 1561 as amended. If nothing was paid for good will acquired after February 28, 1913, no deductible loss with respect thereto is possible, although on the other hand, upon the sale of the business there may be a profit. It is immaterial that good will may never have been carried on the books as an asset, but the burden of proof is on the taxpayer to establish the cost or fair market value on March 1, 1913, of the good will sold. See article 163.

Art. 43. *Sale of real estate in lots.*—Where a tract of land is purchased with a view to dividing it into lots or parcels of ground to be sold as such the cost shall be equitably apportioned to the several lots or parcels and made a matter of record on the books of the taxpayer, to the end that any gain derived from the sale of any such lots or parcels which constitutes taxable income, may be returned as income for the year in which the sale was made. This rule contemplates that there will be a measure of gain or loss on every lot or parcel sold, and not that the capital invested in the entire tract shall be extinguished before any taxable income shall be returned. The sale of each lot or parcel will be treated as a separate transaction and the gain or loss will be accounted for as provided in article 1561 as amended. . . .

ART. 87. *Income accruing prior to March 1, 1913.*—Any liquidated claim existing unconditionally on March 1, 1913, and then assignable, whether presently payable or not and held by a taxpayer prior to March 1, 1913, whether evidenced by writing or not; and all interest which had accrued thereon before that date, do not constitute taxable income, although actually recovered or received subsequent to such date. Interest accruing on or after that date is taxable income. Where an interest-bearing claim held on February 28, 1913, is paid in whole or in part after that date, any gain derived from the payment of the claim is taxable. The amount of such gain is the excess of the proceeds of the claim (both principal and interest) exclusive of any interest accrued since February 28, 1913, already returned as income, over the cost thereof (both principal and interest then accrued). However, the gain which is taxable where the fair market value of the claim as of March 1, 1913, is greater than the cost thereof, is the excess of the amount received over such value. No gain results where the amount received from the claim is more than the cost thereof but less than its fair market value as of March 1, 1913. In the case of an insurance policy its surrender value as of March 1, 1913, may be used as a basis for the purpose of ascertaining the gain derived from the sale or other disposition of such property. Where services were rendered prior to March 1, 1913, but paid for thereafter, the amount received is taxable income to the extent of the excess of such amount over the fair market value on March 1, 1913, of the principal of the claim and any interest which had then accrued. Interest does not include dividends on corporate stock. See section 201 of the statute, and articles 1541-1549 as amended.

ART. 141. *Losses.*—Losses sustained during the taxable year and not compensated for by insurance or otherwise are fully deductible (except by

nonresident aliens) if (*a*) incurred in a taxpayer's trade or business, or (*b*) incurred in any transaction entered into for profit, or (*c*) arising from fires, storms, shipwreck, or other casualty, or theft. They must usually be evidenced by closed and completed transactions. In the case of the sale of assets the loss will be the difference between the cost thereof, less depreciation sustained since acquisition. However, the loss which is deductible in the case where such property was acquired before March 1, 1913, and where its fair market value on that date was less than the cost thereof, is the difference between such value (less depreciation), and the price at which sold or disposed of. No loss is recognized in the case of property sold at less than cost minus depreciation but for more than its fair market value as of March 1, 1913. See section 202 of the statute, and articles 39-46 and 1561 as amended. When loss is claimed through the destruction of property by fire, flood or other casualty, the amount deductible will be the difference between the cost of the property and the salvage value thereof, after deducting from such cost, the amount, if any, which has been or should have been set aside and deducted in the current year and previous years from gross income on account of depreciation and which has not been paid out in making good the depreciation sustained. In the case of property acquired before March 1, 1913, when the fair market value as of that date is lower than the cost, the deductible loss is the difference between such value and the salvage value thereof after deducting from the value as of March 1, 1913, the amount, if any, which has been or should have been set aside and deducted in the current year and previous years from gross income on account of depreciation and which has not been paid out in making good the depreciation sustained. No loss is recognized where the salvage value is less than the cost but more than the depreciated value of such property as of March 1, 1913. In any event the loss should be reduced by the amount of any insur-

ance or other compensation received. See articles 49 and 50. A loss on the sale of residential property is not deductible unless the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit. Losses in illegal transactions are not deductible. Where a person gives away property, or is divested thereof by death, no realization of loss results therefrom.

Art. 143. *Loss of useful value.*—When, through some change in business conditions, the usefulness in the business of some or all of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in such business, he may claim as a loss for the year in which he takes such action the difference between the cost, or, if acquired prior to March 1, 1913, the cost or fair market price or value as of that date, whichever is lower, of any assets so discarded (less any depreciation sustained) and its salvage value remaining. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property has been prematurely discarded, as, for example, where an increase in the cost of or other change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized. It does not apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be charged off on the books and fully explained in returns of income. But see articles 181-189.

Art. 144. *Shrinkage in securities and stocks.*—A person possessing securities, such as stock and bonds, can not deduct from gross income any amount claimed as a loss on account of shrinkage in value of such securities through fluctuation of the market or otherwise. The loss allowable in such cases is that actually suffered when the securities mature or are disposed of. See, however, article 154. In the case of banks or other corporations which are subject to supervision by State or Federal authorities, and which in obedience to the orders of such supervisory officers charge off as losses amounts representing an alleged shrinkage in the value of property, the amounts so charged off do not constitute allowable deductions. However, if stock of a corporation becomes worthless its cost, or if acquired prior to March 1, 1913, its cost or fair market value as of that date, whichever is lower, may be deducted by the owners in the taxable year in which the stock becomes worthless, provided a satisfactory showing of its worthlessness be made as in the case of bad debts. See article 151.

Art. 545. *Sale of capital assets.*—Where property is acquired and later sold for a higher price the gain on the sale is income. If, however, the property was acquired before March 1, 1913, only such portion of the gain as accrued subsequently to February 28, 1913, is taxable. Where, then, a corporation sells its capital assets in whole or in part it shall include in its gross income for the year in which the sale was made the amount of the excess of the sales price over the cost unless it acquired such assets prior to March 1, 1913, and the fair market value of such assets as of such date was in excess of the cost, in which case it shall include the excess of the amount of the sales price over such value. No gain or loss is recognized in case the assets are sold (*a*) at more than cost but at less than their fair market value as of March 1, 1913, or (*b*) at less than cost but at more than their

fair market value as of March 1, 1913. In every case, however, in ascertaining the gain, the cost of the assets, or the fair market value as of March 1, 1913, of the assets acquired prior thereto, should first be reduced by the amount of any charges for depreciation, depletion, and other deductions which have been or should have been taken. If the purchaser takes over all the assets and assumes the liabilities, the amount so assumed is part of the purchase price. See also article 563 as amended. If the sale is made for stock of another corporation, the rules contained in section 202 of the statute and in articles 1561-1570 as amended are particularly applicable.

ART. 563. *Sale of capital stock, bonds, and capital assets.*—A corporation sustains no deductible loss from the sale of its capital stock. See article 542. If it sells its bonds at a discount, the amount of such discount is treated in the same way as interest paid, and if it retires its bonds at a price in excess of the issuing price, such excess may usually be deducted as expense. See articles 544 and 848 as amended. If a corporation sells its capital assets for less than their cost, the loss sustained is deductible unless the assets were acquired before March 1, 1913, and sold at less than cost, but at more than their fair market value as of March 1, 1913. The loss which is deductible in the case where assets acquired before March 1, 1913, are sold after that date at less than cost and less than their fair market value as of that date, and such value was less than cost, is the difference between such price or value and the amount realized by the sale or exchange. See article 545 as amended.

. . . . . .

ART. 1561. *Basis for determining gain or loss from sale.*—For the purpose of ascertaining the gain or loss from the sale or exchange of property the basis is the cost of such property, or if acquired

on or after March 1, 1913, its cost or its approved inventory value. But in the case of property acquired before March 1, 1913, when its fair market value as of that date is in excess of its cost, the gain which is taxable is the excess of the amount realized therefor over such fair market value. Also in the case of property acquired before March 1, 1913, when its fair market value as of that date is lower than its cost, the deductible loss is the excess of such fair market value over the amount realized therefor. No gain or loss is recognized in the case of property sold or exchanged (*a*) at more than cost but at less than its fair market value as of March 1, 1913, or (*b*) at less than cost but at more than its fair market value as of March 1, 1913. In any case proper adjustment must be made for any depreciation or depletion sustained. What the fair market value of property was on March 1, 1913, is a question of fact to be established by any evidence which will reasonably and adequately make it appear. As to inventories see section 203 of the statute and articles 1581-1588. The fair market value as of March 1, 1913, has no bearing on the determination of the invested capital of a corporation for the purpose of the war profits and excess profits tax. See section 326 and article 831.

ART. 1562. *Sale of property acquired by gift or bequest.*—The cost of such property to the person making the sale or other disposition thereof is the fair market value of the property at the date of acquisition and the taxable gain derived or the deductible loss sustained from such sale or other disposition shall be computed in accordance with the provisions of article 1561 as amended. For the purpose of determining the profit or loss from sale of property acquired by bequest, devise, or descent since February 28, 1913, its value as appraised for the purpose of the Federal estate tax, or in the case of estates not subject to that tax, its value as appraised in the State court for the purpose of

State inheritance taxes, should be deemed to be its fair market value when acquired. See section 213 (*b*) (3) of the statute and article 73.

Art. 1564. *Determination of gain or loss from exchange of property.*—(*a*) The amount of income derived from an exchange of property, as of stock for a bond, is the excess of the fair market value at the time of exchange of the property received in exchange over the original cost of the property exchanged for it. If the property exchanged was acquired prior to March 1, 1913, and its fair market value on that date was greater than the cost, the income which is taxable is the excess of the fair market value at the time of exchange of the property received in exchange over the fair market value on March 1, 1913, of the property exchanged. No gain is recognized if the fair market value of the property received in exchange is more than the cost of the property exchanged but less than its fair market value as of March 1, 1913. The amount of income derived from a subsequent sale for cash of property received in exchange for other property on or after March 1, 1913, is the excess of the amount so received over the fair market value of the property acquired at the date of the acquisition. (*b*) If the property received in exchange is substantially the same property or has no market value, then no gain or loss is realized, but the new property is to be regarded as substituted for the old, and upon the sale of the new property the amount of income derived is the excess of the amount so received over the cost of the old. However, if the old was acquired prior to March 1, 1913, and its fair market value as of that date is in excess of its cost but less than the amount received, the taxable gain is the excess over such value as of March 1, 1913, of the amount received. No gain is recognized if the property is sold at more than the cost of the old property but at less than its fair market value as of March 1, 1913.

ART. 1565. *Exchange for different kinds of property.*—(*a*) If property is exchanged for two different kinds of property, such as bonds and stock, the bonds having a market value and the stock none, the value of the bonds is to be compared with the cost. If the market value of the bonds is less than such cost the difference represents the cost of the stock. If the market value of the bonds is greater than such cost the difference represents gain and is taxable at the time of the exchange unless the original property was acquired prior to March 1, 1913, in which case the amount of gain taxable is computed as provided in article 1564 as amended. In either case the entire proceeds of such stock will be taxable. (*b*) If property is exchanged for two different kinds of property, such as bonds and stocks, neither having a fair market value, the cost of the original property should be apportioned, if possible, between the bonds and stock for the purpose of determining gain or loss on subsequent sales. If no fair apportionment is practicable, no profit on any subsequent sale of any part of the bonds or stock is realized until out of the proceeds of sales shall have been recovered the entire cost of the original property.

ART. 1566. *Exchange of property and stock.*—Where property is transferred to a corporation in exchange for its stock, the exchange constitutes a closed transaction, and the former owner of the property realizes a gain or loss if the stock has a market value and such market value is greater or less than the cost of the property given in exchange. However, if the property was acquired prior to March 1, 1913, the amount of taxable gain or deductible loss shall be determined in accordance with article 1561 as amended. For the rule applicable where a corporation, in connection with a reorganization, merger, or consolidation, exchanges property for stock, see article 1567.

. . . .

ART. 1569. *Exchange of stock for other stock of greater par value.*—If in the case of any reorganization, merger, or consolidation, the aggregate par or face value of the new stock or securities received is in excess of the aggregate par or face value of the stock or securities exchanged, income will be realized from the transaction by the recipients of the new stock or securities to an amount limited by (*a*) the excess of the par or face value of the new stock or securities over the par or face value of the old, and (*b*) the excess of the fair market value of the new stock or securities over the cost of the old, unless the old stock or securities were acquired prior to March 1, 1913, and their fair market price or value as of that date was greater than their cost, in which case the fair market value of the new stock or securities must be in excess of the fair market value as of March 1, 1913, of the old. The taxable profit will be (*a*) or (*b*), whichever is less. On a subsequent sale of the new stock or securities their cost to the taxpayer will be the cost of the old stock or securities plus the profit taxed on the exchange." (T. D. 3206, approved July 8, 1921.)

(2) As to depreciation and depletion:

The regulations with respect to deductions for depreciation and depletion were not amended following the decision in *Goodrich* v. *Edwards*, but remained as before. See page 33 above.

IV. INSTRUCTIONS ON RETURN FORMS

(1) For the years 1918, 1919 and 1920:

"D. PROFIT FROM SALE OF LAND, BUILDINGS, STOCKS, BONDS, AND OTHER PROPERTY.

1. Kind of Property	2. Year acquired	3. Name and address of purchaser or broker	4. Sale Price	5. Original cost or market value Mar. 1, 1913	6. Cost of subsequent improvements, if any	7. Depreciation subsequently sustained

NET PROFIT FROM SALES (Total of columns 4 and 7 minus total of columns 5 and 6).

"Use this schedule for all sales of real estate, and for sales of other property that you did not deal in as a business.

"If the profits or losses on sales made through any one broker aggregated $1,000 or more, report the transaction on a separate line with the name and address of the broker.

"Kind of property. Describe the property as definitely as you can in a word or two, as 'farm', 'house', 'lot', 'stocks', 'bonds'.

"Sale price. State the actual consideration or price, or, in case of an exchange, the fair market value of the property received.

"Cost. Enter the original cost of the property or, if it was acquired before March 1, 1913, its fair market value on that date. Expenses incidental to the purchase may be included in the cost if never claimed in income-tax returns as deductions from income. Enter in column 7 the amount of wear and tear, obsolescence, or depletion sustained since March 1, 1913 (or since date of acquisition if subsequent to March 1, 1913). (This is a deduction from cost, though treated for convenience as an addition to the sale price.)

"Losses. If the total of columns 5 and 6 is in excess of the total of columns 4 and 7, report the difference as a loss by using red ink or a minus sign."

C.

Revenue Act of 1921

I. Statute

(1) As to gains and losses:

"That for the purposes of this title . . . the term 'gross income'—

(a) includes gains, profits, and income derived from . . . sales, or dealings in property, whether real or personal, . . ." (Secs. 213 (a) and 233 (a).)

"That in computing net income there shall be allowed as deductions [in the case of an individual]: . . .

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;

(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; but in the case of a non-resident alien individual only if and to the extent that the profit, if such transaction had resulted in a profit, would be taxable under this title; . . .

(6) Losses sustained during the taxable year of property not connected with the trade or business (but in the case of a non-resident alien individual only property within the United States) if arising from fires, storms, shipwreck, or other casualty, or from theft, and if not compensated for by insurance or otherwise. Losses allowed under paragraphs (4), (5), and (6) of this subdivision shall be deducted as of the taxable year in which sustained unless, in order to clearly reflect the income, the loss should, in the opinion of the Commissioner, be accounted for as of a different period. In case of losses arising from destruction of or damage to property, where the property so destroyed or damaged was acquired before March 1, 1913, the deduction shall be computed upon the basis of its fair market price or value as of March 1, 1913;" (Sec. 214 (a).)

"That in computing the net income of a corporation . . . there shall be allowed as deductions: . . .

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise; unless, in order to clearly reflect the income, the loss should in the opinion of the Commissioner

be accounted for as of a different period. . . . In case of losses arising from destruction of or damage to property, where the property so destroyed or damaged was acquired before March 1, 1913, the deduction shall be computed upon the basis of its fair market price or value as of March 1, 1913;" (Sec. 234 (a).)

"(a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; except that—

(1) In the case of such property, which should be included in the inventory, the basis shall be the last inventory value thereof;

(2) In the case of such property, acquired by gift after December 31, 1920, the basis shall be the same as that which it would have in the hands of the donor or the last preceding owner by whom it was not acquired by gift. If the facts necessary to determine such basis are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be the value of such property as found by the Commissioner as of the date or approximate date at which, according to the best information the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner. In the case of such property acquired by gift on or before December 31, 1920, the basis for ascertaining gain or loss from a sale or other disposition thereof shall be the fair market price or value of such property at the time of such acquisition;

(3) In the case of such property, acquired by bequest, devise, or inheritance, the basis shall be the fair market price or value of such property

at the time of such acquisition. The provisions of this paragraph shall apply to the acquisition of such property interests as are specified in subdivision (c) or (e) of section 402.

(b) The basis for ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March 1, 1913, shall be the same as that provided by subdivision (a); but—

(1) If its fair market price or value as of March 1, 1913, is in excess of such basis, the gain to be included in the gross income shall be the excess of the amount realized therefor over such fair market price or value;

(2) If its fair market price or value as of March 1, 1913, is lower than such basis, the deductible loss is the excess of the fair market price or value as of March 1, 1913, over the amount realized therefor; and

(3) If the amount realized therefor is more than such basis but not more than its fair market price or value as of March 1, 1913, or less than such basis but not less than such fair market price or value, no gain shall be included in and no loss deducted from the gross income. (Sec. 202 (a) (b).)

(2) As to depreciation and depletion:

"That in computing net income there shall be allowed as deductions: . . .

(8) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. In the case of such property acquired before March 1, 1913, this deduction shall be computed upon the basis of its fair market price or value as of March 1, 1913; . . .

(10) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable

allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted; *Provided,* That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: *Provided further,* That in the case of mines, oil and gas wells, discovered by the taxpayer, on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of the discovery, or within thirty days thereafter: *And provided further,* That such depletion allowance based on discovery value shall not exceed the net income, computed without allowance for depletion, from the property upon which the discovery is made, except where such net income so computed is less than the depletion allowance based on cost or fair market value as of March 1, 1913; . . ." (Secs. 214 (a) and 234 (a).)

II. Regulations

(1) As to gains and losses:

The more material regulations of the Treasury Department for the administration of the pertinent provisions of the Revenue Act of 1921 relating to the determination of gains and losses derived from sales or dealings in property are substantially the same as the regulations after March 28, 1921, for the administration of the corresponding provisions of the Revenue Act of 1918. Those articles of the regulations for the administration of the pertinent provisions of the Revenue Act of 1921 which are a departure from the former regulations are reproduced below.

"*Art. 141. Losses.*—Losses sustained during the taxable year and not compensated for by in-

surance or otherwise are fully deductible (except by non-resident aliens) if (a) incurred in a taxpayer's trade or business, or (b) incurred in any transaction entered into for profit, or (c) arising from fires, storms, shipwreck, or other casualty, or theft. They must usually be evidenced by closed and completed transactions.

In the case of the sale of assets the loss will be the difference between the cost thereof, less depreciation sustained and allowable as a deduction in computing net income, and the price at which sold or disposed of. See article 1561. However, the loss which is deductible in the case where such property was acquired before March 1, 1913, and where its fair market value on that date was less than the cost thereof, is the difference between such value (less depreciation) and the price at which sold or disposed of. No loss is recognized in the case of property sold at less than cost minus depreciation but for more than its fair market value as of March 1, 1913, or for more than cost but less than the fair market value as of March 1, 1913. See section 202 of the statute and articles 39-46 and 1561.

When loss is claimed through the destruction of property by fire, flood, or other casualty, the amount deductible will be the difference between the cost of the property, less proper adjustment for depreciation, and the salvage value thereof. In the case of property acquired before March 1, 1913, however, the deductible loss is the difference between the fair market value of the property as of that date, less proper adjustment for depreciation, and the salvage value thereof. In any event the loss should be reduced by the amount of any insurance or other compensation received. See articles 49 and 261-263. A loss on the sale of residential property is not deductible unless the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit. Where a person gives away property, or is divested thereof by death, no realization of loss results therefrom." (Reg. 62, Art. 141.)

"*Art. 143. Loss of useful value.*—When, through some change in business conditions, the usefulness in the business of some or all of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in such business, he may claim as a loss for the year in which he takes such action the difference between the cost, or, if acquired prior to March 1, 1913, fair market price or value as of that date of any assets so discarded (less any depreciation sustained and allowable as a deduction in computing net income) and its salvage value remaining. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property has been prematurely discarded, as, for example, where an increase in the cost of or other change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized. It does not apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be charged off on the books and fully explained in returns of income. But see articles 181-189." (Reg. 62, Art. 143.)

"*Art. 144. Shrinkage in value of stocks.*—A person possessing stock of a corporation can not deduct from gross income any amount claimed as a loss merely on account of shrinkage in value of such stock through fluctuation of the market or

otherwise. The loss allowable in such cases is that actually suffered when the stock is disposed of. See, however, article 154. However, if stock of a corporation becomes worthless, its cost or other basis determined under section 202 may be deducted by the owner in the taxable year in which the stock became worthless, provided a satisfactory showing of its worthlessness be made, as in the case of bad debts. Where banks or other corporations which are subject to supervision by Federal authorities (or by State authorities maintaining substantially equivalent standards) in obedience to the specific orders or general policy of such supervisory officers charge off stock as worthless or write it down to a nominal value, such stock shall, in the absence of affirmative evidence clearly establishing the contrary, be presumed for income tax purposes to be worthless. See article 151. For dealers in securities, see article 1585." (Reg. 62, Art. 144.)

"*Art. 563. Sale of capital stock, bonds, and capital assets.*—A corporation sustains no deductible loss from the sale of its capital stock. See article 543. If it sells its bonds at a discount, the amount of such discount is treated in the same way as interest paid, and if it retires its bonds at a price in excess of the issuing price, such excess may usually be deducted as expense. See articles 545 and 848. If (1) a corporation sells its capital assets for less than their cost, and such assets were acquired before March 1, 1913, then if the fair market value on March 1, 1913, less depreciation subsequently sustained and allowable as a deduction is less than the amount realized, no loss is deductible; if (2) such fair market value less depreciation subsequently sustained and allowable as a deduction is greater than the amount realized, but the amount realized exceeds original cost, no loss is deductible; if (3) the amount realized is less than both original cost and the value of March 1, 1913, less depreciation subsequently

sustained and allowable as a deduction, the deductible loss is the difference between such amount realized and such cost or March 1, 1913, value, whichever is lower. See article 546." (Reg. 62, Art. 563.)

"*Art. 1561. Basis for determining gain or loss from sale.*—For the purpose of ascertaining the gain or loss from the sale or exchange of property, the basis is the cost of such property, or in the case of property which should be included in the inventory, its latest inventory value. But in the case of property acquired before March 1, 1913, when its fair market value as of that date is in excess of its cost, the gain to be included in gross income is the excess of the amount realized therefor over such fair market value. Also in the case of property acquired before March 1, 1913, when its fair market value as of that date is lower than its cost, the deductible loss is the excess of such fair market value over the amount realized therefor. No gain or loss is recognized in the case of property sold or exchanged (*a*) at more than cost but at less than its fair market value as of March 1, 1913, or (*b*) at less than cost but at more than its fair market value as of March 1, 1913. In any case proper adjustment must be made in computing gain or loss from the exchange or sale of property for any depreciation or depletion sustained and allowable as a deduction in computing net income; the amount of depreciation previously charged off by the taxpayer shall be deemed to be the true depreciation sustained unless shown by clear and convincing evidence to be incorrect. What the fair market value of property was on March 1, 1913, is a question of fact to be established by any evidence which will reasonably and adequately make it appear. In the case of property traded in on public exchanges, evidence of actual sales at or about March 1, 1913, or other basic date, affords evidence of value, but it must not be regarded as conclusive. The nature and extent of the sales and the circumstances under

which they were made should be considered. Prices received at forced sales or for small lots of property may be and often are no real indication of the value of the amount of property in question. For instance, sales from time to time of a small number of shares of stock is little indication of the value of a large or controlling interest in the corporation. As to inventories, see section 203 of the statute and articles 1581-1588. As to sale of stock upon which dividends have been declared, see articles 1543, 1544 and 1546. The fair market value as of March 1, 1913, has no bearing on the determination of the invested capital of a corporation for the purpose of the war profits and excess profits tax. See section 326 and article 831. As to exchanges, see further, articles 1564-1568. If the taxpayer can not determine the cost of securities purchased prior to March 1, 1913, because of the loss, destruction or failure to keep records, the value of the securities at the date or approximate date of acquisition may be used in determining the cost basis for purposes of computing the gain or loss from the sale of the securities. When the date or approximate date of acquisition is unknown, no general rule can be stated for determining the cost value of such securities. Each case must be considered separately upon its own facts.

Illustrations of the computation of gain or loss from the sale or exchange of property acquired prior to March 1, 1913.—To avoid complexity no adjustment has been made in these examples for depreciation or depletion.

In the case of property acquired before March 1, 1913, when its fair market value as of that date is in excess of its cost, the taxable gain is the excess of the amount realized therefor over such fair market value.

Cost	*Fair Market Value March 1, 1913*	*Sale Price*	*Taxable Gain*
$10,000	$15,000	$20,000	$5,000. Excess of amount realized over fair market value as at March 1, 1913. Gain attributable to the period prior to March 1, 1913, not taxable.

In the case of property acquired before March 1, 1913, when its fair market value as of that date is lower than its cost, the deductible loss is the excess of such fair market value over the amount realized therefor.

Cost	*Fair Market Value March 1, 1913*	*Sale Price*	*Deductible Loss*
$10,000	$5,000	$3,000	$2,000. Excess of fair market value over amount realized. Loss attributable to the period prior to March 1, 1913, not deductible.

No gain or loss is recognized in the case of property acquired before March 1, 1913, and sold or disposed of at more than cost but at less than its fair market value as of that date.

Cost	*Fair Market Value March 1, 1913*	*Sale Price*	
$10,000	$30,000	$20,000	No taxable gain or deductible loss. Reason: A gain on whole transaction, which gain is attributable to period prior to March 1, 1913.

No gain or loss is recognized in the case of property acquired before March 1, 1913, and sold or disposed of at less than cost but at more than its fair market value as of that date.

Cost	*Fair Market Value March 1, 1913*	*Sale Price*	
$10,000	$3,000	$5,000	No taxable gain or deductible loss. Reason: A loss on whole transaction, which loss is attributable to period prior to March 1, 1913.

Where the cost is equal to or greater than the fair market value as of March 1, 1913, and the selling price exceeds the cost, the gain to be included in gross income is the excess of the selling price over the cost.

Cost	Fair Market Value March 1, 1913	Sale Price	Taxable Gain
$10,000	$5,000	$20,000	$10,000. Reason: Gain on whole transaction, all of which is attributabel to period subsequent to March 1, 1913.

Where the fair market value as at March 1, 1913, is greater than the cost and the selling price is less than the cost, the deductible loss is the amount by which the cost exceeds the selling price.

Cost	Fair Market Value March 1, 1913	Sale Price	Deductible Loss
$10,000	$15,000	$5,000	$5,000. Reason: Loss on whole transaction, all of which is attributable to period subsequent to March 1, 1913. Only actual loss sustained deductible."

(Reg. 62, Art. 1561.)

"*Art. 1565. Determination of gain or loss from the exchange of property.*—The amount of income derived or loss sustained from an exchange of property is the difference between the fair market value (if readily realizable) at the time of the exchange of the property received in exchange and the original cost, or other basis, of the property exchanged. If the property exchanged was acquired prior to March 1, 1913, see article 1561." (Reg. 62, Art. 1565.)

(2) As to depreciation and depletion:

"*Art. 161. Depreciation.*—A reasonable allowance for the exhaustion, wear and tear and obsolescence of property used in the trade or business may be deducted from gross income. For convenience such an allowance will usually be referred

to as depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear, or obsolescence. The proper allowance for such depreciation of any property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate) by which the aggregate of such amounts for the useful life of the property in the business will suffice, with the salvage value, and having due regard for expenditures made for current upkeep, at the end of such useful life to provide in place of the property its original cost (not replacement cost), or its value as of March 1, 1913, if acquired by the taxpayer before that date. See further articles 839 and 844." (Reg. 62, Art. 161.)

"*Art. 201. Depletion of mines, oil and gas wells; depreciation of improvements.*—Sections 214 (a) (10) and 234 (a) (9) provide that taxpayers shall be allowed as a deduction in computing net income in the case of natural deposits a reasonable allowance for depletion of mineral and for depreciation of improvements. These paragraphs of the statute are not materially different from the corresponding paragraphs of the Revenue Act of 1918. These provisions of the statute and articles 201-237 do not apply to or affect the regulations covering invested capital, losses, accounting methods, etc.

The essence of these provisions of the statute is that the owner of mineral deposits, whether freehold or leasehold, shall, within the limitations prescribed, secure through an aggregate of annual depletion and depreciation deductions the return of either (a) the cost of his property if acquired subsequent to March 1, 1913, or (b) the value of his property on the basic date, plus subsequent allowable capital additions (see art. 222), but not including land values for purposes other than the extraction of minerals.

* * * * * *

When used in these articles (201—237) covering depletion and depreciation—

(a) The term 'basic date' indicates the date of valuation, i. e., March 1, 1913, in the case of property acquired prior thereto; the date of acquisition in the case of property acquired on or after March 1, 1913; or the date of discovery, or within 30 days thereafter, in the case of discovery." (Reg. 62, Art. 201.)

D.

Opinion of Attorney General.

"Department of Justice,
Washington,

August 23, 1922.

The Honorable,
The Secretary of the Treasury.

Sir:

"I have the honor to acknowledge receipt of your letter of June 26, 1922, in which you request my opinion as to the proper basis to be used, under the Revenue Acts of 1916, 1917 and 1918, in computing the taxable gain or deductible loss in the case where property, acquired prior to March 1, 1913, is sold or disposed of thereafter. Accompanying your letter was a brief submitted by the M Company in which the validity of the Regulations of the Internal Revenue and the procedure thereunder are questioned by the Company specifically as to the following cases:

"Where property acquired prior to March 1, 1913, is sold subsequent thereto at a price which is—

(a) Greater than the value thereof on March 1, 1913, which was higher than cost, or

(b) Greater than the cost thereof, which was higher than the value on March 1, 1913, or

(c) Greater than the value thereof on March 1, 1913, but less than cost, or

(d) Less than the value thereof on March 1, 1913, which was less than cost, or

(e) Less than the value thereof on March 1, 1913, but greater than cost, or

(f) Less than the cost thereof, which was less than the value on March 1, 1913.

The provisions of the Revenue Act of 1916 material to the subject under consideration, and not changed in any way by the Act of 1917, are:

"Sec. 2. (a) That, subject to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits, and income derived from . . . businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

. . . . . .

"(c) For the purpose of ascertaining the gain derived from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived.

"Sec. 5. . . .

"(a) For the purpose of the tax there shall be allowed as deductions—

"Fourth. Losses actually sustained during the year, incurred in his business or trade, . . . *Provided,* That for the purpose of ascertaining the

loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such loss sustained;

"Fifth. In transactions entered into for profit but not connected with his business or trade, the losses actually sustained therein during the year to an amount not exceeding the profits arising therefrom;

. . . .

"Sec. 10. . . . For the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition by a corporation, joint-stock company, or association, or insurance company, of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived or loss sustained."

The Act of 1918, dealing with the questions propounded, are:

"Sec. 202 (a). That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

"(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

"(2) In the case of property acquired on or after that date, the cost thereof; or the inventory value, if the inventory is made in accordance with section 203."

"Sec. 213. That for the purposes of this title . . . the term 'gross income'—

"(a) Includes gains, profits, and income derived from . . . trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever . . . ."

Treasury Decision 3206 reads, in part, as follows:

"Regulations 45 (1920 Edition) are hereby amended in order that the rule announced by the Supreme Court in the cases of Goodrich *v.* Edwards, and Brewster *v.* Walsh, respecting the basis for the determination of taxable gain or deductible loss in the case of property acquired prior to March 1, 1913, and sold or disposed of subsequent thereto, may be incorporated therein. . . .

"*Art. 1561. Basis for determining gain or loss from sale.*—For the purpose of ascertaining the gain or loss from the sale or exchange of property the basis is the cost of such property, or if acquired on or after March 1, 1913, its cost or its approved inventory value. But in the case of property acquired before March 1, 1913, when its fair market value as of that date is in excess of its cost, the gain which is taxable is the excess of the amount realized therefor over such fair market value. Also in the case of property acquired before March 1, 1913, when its fair market value as of that date is lower than its cost, the deductible loss is the excess of such fair market value over the amount realized therefor. No gain or loss is recognized in the case of property sold or exchanged (*a*) at more than cost but at less than its fair market value as of March 1, 1913, or (*b*) at less than cost but at more than its fair market value as of March 1, 1913. . . ."

In the case of Goodrich *v.* Edwards, 255 U. S. 527, the question of what constituted gain within the meaning of

the Revenue Act of 1916 was passed upon by the United States Supreme Court, which adopted a concession made by the Solicitor General to the effect that where no gain was realized by the taxpayer on a complete transaction, notwithstanding that the selling price was higher than the value on March 1, 1913, no tax should have been assessed against him; holding that section 2 (*c*) was applicable only where a gain over the original capital investment had been realized after March 1, 1913, from a sale or other disposition of property, establishing the rule that increases in value occurring prior to March 1, 1913, should be excluded in computing taxable gain, and that only increases occurring subsequent to such date should be taxed.

Taxable gain having been thus construed by the Supreme Court, it follows that "deductible loss" should have the same construction, the provisions relating to losses being practically identical with those relating to gain. In making the concession as to taxable gains, the Solicitor General, in his brief in the Goodrich cases, cited above, made the further concession that a loss on the complete transaction must have been sustained in order to make it a deductible loss, and that only the loss occurring subsequent to March 1, 1913, should be allowed as a deduction.

The provisions of the Revenue Act of 1918 which deal with the subject of taxable gains and deductible losses are:

> "Sec. 202 (*a*). That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal or mixed, the basis shall be—

"(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

"(2) In the case of property acquired on or after that date, the cost thereof; or the inventory value, if the inventory is made in accordance with section 203."

"Sec. 213. That for the purpose of this title . . . the term 'gross income'—

"(*a*) Includes gains, profits, and income derived from . . . trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. . . ."

No substantial changes having been made in the corresponding sections of the two Acts, it is assumed that both Acts were intended by Congress to have the same construction, and the same basis should be employed in arriving at taxable gains and deductible losses upon the sale or other disposition of property.

I am of the opinion that the date March 1, 1913, was intended to be used as a guide in ascertaining gains derived or losses sustained, but that the original cost should be taken into consideration, so that if there was no gain on the entire transaction there was no taxable gain, and if there was no loss on the entire transaction there was no deductible loss. It follows, therefore, that in limiting the M Company to the loss sustained by it on the sale of shares of stock of the O Company, that is, the difference between cost and selling price, instead of to the difference

between March 1, 1913, value and selling price, the Internal Revenue Bureau acted in accordance with law. In other words, the basis to be employed, under the Acts of 1916, 1917 and 1918, for the purpose of ascertaining the gain or loss from the sale or other disposition of property is the cost; and that in the case of property acquired prior to March 1, 1913, when its fair market value as of that date is in excess of its cost, the taxable gain is the excess of the amount realized over such fair market value; that when its fair market value as of March 1, 1913, is lower than its cost, the deductible loss is the excess of such fair market value over the amount realized therefor; and that when the property is sold or otherwise disposed of at more than cost but at less than March 1, 1913, value, or at less than cost but at more than March 1, 1913, value, neither taxable gain nor deductible loss results.

Replying specifically to the inquiry, I am of the opinion that where property acquired prior to March 1, 1913, is sold or disposed of thereafter—

(*a*) Taxable gain resulted if the selling price was higher than the value on March 1, 1913, and if that value was higher than the cost thereof, to the extent that the selling price exceeded the value on March 1, 1913;

(*b*) Taxable gain resulted if the selling price was greater than the cost and if the cost was greater than the value on March 1, 1913, to the extent that the selling price exceeded the cost of the property sold or disposed of;

(*c*) No taxable gain or allowable loss resulted if the selling price was greater than the value of the property on March 1, 1913, but less than the cost thereof;

(*d*) An allowable loss resulted if the selling price was less than the value on March 1, 1913, and if that value was less than the cost to the extent of the difference between the value on March 1, 1913, and the selling price;

(*e*) No taxable gain or deductible loss resulted if the selling price was less than the value thereof on March 1, 1913, but greater than the cost; or

(*f*) An allowable loss resulted if the selling price was less than the cost and if the cost was less than the value on March 1, 1913, to the extent that the cost of the property disposed of exceeded the selling price thereof.

Respectfully,

H. M. Daugherty, Attorney General."